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TC01-044

TC01-044

DOCKET NO.

In the Matter of — IN THE MATTER OF THE APPLICATION OF T-NETIX TELECOMMUNICATIONS SERVICES, INC. FOR A CERTIFICATE OF AUTHORITY TO PROVIDE INTEREXCHANGE TELECOMMUNICATIONS SERVICES IN SOUTH DAKOTA

Public Utilities Commission of the State of South Dakota

DATE	MEMORANDA
4/12/01	Received Filing;
4/23/01	Received Check and Docketed;
4/26/01	Weekly Filing;
5/14/01	Order Granting COA;
5/14/01	Docket Closed.

TC01-044

RECEIVED

APR 12 2001

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

Lance J.M. Steinhart, P.C.
Attorney At Law
6455 East Johns Crossing
Suite 285
Duluth, Georgia 30097

Also Admitted in New York and Maryland

Telephone: (770) 232-9200
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April 11, 2001

VIA OVERNIGHT DELIVERY

Mr. William Bullard
Executive Director
South Dakota Public Utilities Commission
500 East Capitol Avenue
Ave-Pierre, SD 57501-5070
(605) 773-3201

Re: T-NETIX Telecommunications Services, Inc.
Inmate Service Providers

Dear Mr. Bullard:

Enclosed please find one original and ten (10) copies of T-NETIX Telecommunications Services, Inc.'s Application for Registration of a Telecommunications Company.

I have also enclosed a check in the amount of $250.00 payable to the "South Dakota Public Utilities Commission" for the filing fee, and an extra copy of this cover letter to be date stamped and returned to me in the enclosed self-addressed prepaid envelope.

If you have any questions or if I may provide you with any additional information, please do not hesitate to contact me.

Respectfully submitted,

Lance J.M. Steinhart
Attorney for T-NETIX Telecommunications Services, Inc.

Enclosures
cc: Richard Cree

TC01-044

APPLICATION FOR REGISTRATION
OF T-NETIX TELECOMMUNICATIONS SERVICES, INC.
FILED WITH THE
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF T-NETIX TELECOMMUNICATIONS SERVICES, INC. FOR AN ORDER AUTHORIZING THE REGISTRATION OF APPLICANT AS A TELECOMMUNICATIONS COMPANY	))))))))	Docket No.

RECEIVED
APR 12 2001
SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION

APPLICATION

Application is hereby made to the South Dakota Public Utilities Commission for an Order authorizing T-NETIX Telecommunications Services, Inc. ("Applicant") to register as a telecommunications company within the State of South Dakota. The following information is furnished in support thereof:

1. **Name, Address and Telephone Number of Applicant:**
T-NETIX Telecommunications Services, Inc.
1544 Valwood Parkway, Suite 102
Carrollton, Texas 75006
Telephone: (972) 241-1535
Toll-Free Customer Service: (800) 559-1535

2. **The name under which the Applicant will provide these services if different than in 1. above:**

T-NETIX Telecommunications Services, Inc.

3. <u>Applicant's corporate information:</u>

Applicant was organized in the State of Texas on February 11, 1988. A copy of the Applicant's Articles of Incorporation is attached hereto as Exhibit A. A copy of Applicant's Certificate of Authority to transact business as a foreign corporation in the State of South Dakota is attached hereto as Exhibit B. Applicant is a wholly-owned subsidiary of T-NETIX, Inc., a publicly-held corporation.

The Applicant has no principal office in South Dakota. The name and address of the Applicant's registered agent is:

National Corporate Research, Ltd.
C/O Marilyn Person
819 West Third
Pierre, South Dakota 57501

The names and address of each corporation, association, partnership, cooperative, or individual holding a 20% or greater ownership or management interest in the Applicant corporation and the amount and character of the ownership or management interest are as follows:

Name and Address	Shares Owned	Percentage of all Shares Issued and Outstanding and Voting Control
T-NETIX, INC.	729,004	100%

All of the above can be reached through the company as set forth in Section 1 above.

4. **Partnership Information:**

Not Applicable.

5. **Description of Services Applicant intends to offer:**

Applicant's primary business is providing specialized call processing and other services to the corrections industry. The services will be limited to collect calls initiated by inmates from coin telephones in correctional facilities. The Applicant will offer call control features including: one-way, out-going only service; blocked access to "411", 800/888/877, 900 and other calls; caller ID blocking to outside parties, and call recording and management.

Applicant intends to provide high quality service, with an industry standard blocking rate less than P.01. Its services will be available on a full-time basis, twenty-four hours a day, seven days a week, to any correctional facilities which award a contract to Applicant within the geographic boundaries of the State of South Dakota.

6. <u>Means by which the Applicant intends to provide services:</u>

Applicant does not own or maintain any transmission facilities or switching equipment in the State of South Dakota. The only service Applicant will provide is collect calls from inmates in prisons. The Applicant will provide services through WorldCom, its underlying carrier. As a reseller, Applicant has no points of presence in the State of South Dakota, <u>thus Applicant neither owns, leases, nor operates any switching, transmission, or other physical facilities in the State of South Dakota, and no such facilities will be used by Applicant in providing service in the State of South Dakota.</u>

7. <u>Geographic Areas in which services will be offered:</u>

Applicant intends to provide services to inmate correctional facilities throughout the State of South Dakota.

8. <u>Financial Qualifications:</u>

Applicant is financially qualified to provide intrastate interexchange telecommunications services within South Dakota. In particular, Applicant has adequate access to the capital necessary to fulfill any obligations it may undertake with respect to the provision of intrastate telecommunications services in the State of South Dakota. See Exhibit C, which is attached hereto, T-NETIX, Inc.'s Audited Financial Statements for the years ended December 31, 1998 and December 31, 1999, and

Unaudited Financial Statements for the nine months ended September 30, 2000 for T-NETIX, Inc., which demonstrates that Applicant has the financial ability to provide the services that it proposes to offer.

9. <u>Applicant's complaints and regulatory matters contact and how Applicant handles customer billings and customer service matters.</u>

All inquiries regarding regulatory matters should be addressed to:

Nancy K. Lee, Executive Vice President Regulatory
1544 Valwood Parkway, Suite 102
Carrollton, Texas 75006
Telephone: (972) 241-1535
Facsimile: (972) 241-1537
E-Mail: nancy.lee@t-netix.com

All inquiries regarding complaints should be addressed to:

Kelly Pawless, Customer Service Manager
1544 Valwood Parkway, Suite 102
Carrollton, Texas 75006
Telephone: (972) 241-1535; (800) 559-1535 (toll-free)
Facsimile: (972) 241-1537
E-Mail: kelly.pawless@t-netix.com

Since the only service Applicant will provide is collect calls from inmates in prisons, no customers will be billed by Applicant. All calls are collect calls, therefore, all billing will be sent to the persons accepting the charges for such calls by incumbent local exchange companies. Applicant's toll-free number will be mace available 24 hours per day, seven days per week, and customer service will be provided in-house by the Applicant.

10. <u>Regulatory Status:</u>

Applicant is currently in the process of obtaining all required authorizations from the state regulatory agencies. Applicant is currently authorized to provide service in Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming.

The Applicant is in good standing with the appropriate regulatory agency in the states where it is registered or certified. The Applicant has never been denied registration or certification nor withdrawn its request for registration or certification in any state.

11. Description of Marketing

Applicant will market its services to correctional facilities located in the State of South Dakota. All sales personnel will have telecommunications service experience. Applicant will market through direct sales by employees. Applicant does not intend to engage in multilevel marketing at this time. Applicant's marketing materials are currently being developed and are not available at this time.

12. Cost Support:

Applicant intends to provide services at a price above its cost.

13. Federal Tax Identification Number:

75-2212916

14. The Number and Nature of Complaints filed against the Applicant with any state or federal regulatory commission regarding the unauthorized switching of a customer's telecommunications provider and the act of charging customers for services that have not been ordered:

None

15. Tariff

A copy of Applicant's proposed tariff is attached hereto as Exhibit E.

16. Waivers

Since the Applicant will be providing only collect calls to inmate correctional facilities, Applicant hereby respectfully requests waivers from the Commission to provide the following:

a. Access to Emergency Response Agencies (911);

b. Access to 800, 950 and 10-10-XXXX numbers, all of which will be blocked by Applicant; and

C. Access to directory assistance.

WHEREFORE, the undersigned Applicant requests that the South Dakota Public Utilities Commission enter an order granting this application.

DATED this 11 day of April, 2001.

T-NETIX Telecommunications Services, Inc.

By: ______________________
Lance J.M. Steinhart, Its Counsel

6455 East Johns Crossing
Suite 285
Duluth, Georgia 30097
(770) 232-9200

State of Texas

County of DALLAS

Richard Cree, being first duly sworn, deposes and says that he/she is the President of T-NETIX Telecommunications Services, Inc., the Applicant in the proceeding entitled above, that he/she has read the foregoing application and knows the contents thereof; that the same are true of his/her knowledge, except as to matters which are therein stated on information or belief, and to those matters he/she believes them to be true.

Richard Cree
President

Subscribed and sworn to before this 2ND day of March, 2001.

Sharon A Beck
Notary Public

My Commission expires: 10/29/2004

SHARON A. BECK
MY COMMISSION EXPIRES
October 29, 2004

LIST OF EXHIBITS

A - ARTICLES OF INCORPORATION

B - CERTIFICATE OF AUTHORITY

C - MARKETING MATERIAL

D - FINANCIAL INFORMATION

E - PROPOSED TARIFF

EXHIBIT A - ARTICLES OF INCORPORATION

The State of Texas

SECRETARY OF STATE

CERTIFICATE OF AMENDMENT
OF

T-NETIX TELECOMMUNICATIONS SERVICES, INC.
FORMERLY:
GATEWAY TECHNOLOGIES, INC.

The undersigned, as Secretary of State of Texas, hereby certifies that the attached Articles of Amendment for the above named entity have been received in this office and are found to conform to law.

ACCORDINGLY the undersigned, as Secretary of State, and by virtue of the authority vested in the Secretary by law, hereby issues this Certificate of Amendment.

Dated: **June 15, 2000**

Effective: **June 15, 2000**

THE STATE OF TEXAS

YD

Elton Bomer
Secretary of State

ARTICLES OF AMENDMENT

Pursuant to the provisions of the Texas Business Corporation Act, the undersigned corporation hereby amends its Articles of Incorporation, and for that purpose, submits the following statement:

FILED
In the Office of the
Secretary of State of Texas
JUN 15 2000
Corporations Section

1. The name of the corporation is Gateway Technologies, Inc.

2. Article I of the Articles of Incorporation is hereby amended so as to read as follows: The name of the corporation is T-NETIX Telecommunications Services, Inc.

3. The date of adoption of the amendment is May 23, 2000.

4. The amendment was adopted by unanimous written consent of the sole shareholder. There are 729,004 shares of common stock outstanding and entitled to vote on the amendment.

GATEWAY TECHNOLOGIES, INC.

By: [signature]
Name: Richard E. Cree
Title: President

Date: May 23, 2000

The State of Texas

SECRETARY OF STATE

CERTIFICATE OF AMENDMENT
OF

GATEWAY TECHNOLOGIES, INC.
CHARTER NO. 1055484-0

The undersigned, as Secretary of State of Texas, hereby certifies that the attached Articles of Amendment for the above named entity have been received in this office and are found to conform to law.

ACCORDINGLY the undersigned, as Secretary of State, and by virtue of the authority vested in the Secretary by law, hereby issues this Certificate of Amendment.

Dated: January 10, 1995

Effective: January 10, 1995

pac

Secretary of State

FILED
In the Office of the
Secretary of State of Texas

JAN 10 1995

Corporations Section

ARTICLES OF AMENDMENT
TO THE
ARTICLES OF INCORPORATION
OF
GATEWAY TECHNOLOGIES, INC.

Pursuant to the provisions of Article 4.04 of the Texas Business Corporation Act ("TBCA"), Gateway Technologies, Inc., a Texas corporation (the "Corporation"), adopts the following amendment to the Articles of Incorporation of the Corporation:

ARTICLE I

The name of the Corporation is Gateway Technologies, Inc.

ARTICLE II

The following amendment to the Articles of Incorporation of the Corporation was adopted by the shareholders of the Corporation by unanimous written consent pursuant to Article 9.10.A of the TBCA. The amendment alters and replaces Article IV of the Articles of Incorporation of the Corporation (as amended) in its entirety to read as follows:

The total number of shares of all classes of capital stock which the corporation shall have authority to issue is one million two hundred fifty thousand (1,250,000), of which (a) one million (1,000,000) shares shall be designated as Common Stock, par value $1.00 per share, and (b) two hundred fifty thousand (250,000) shares shall be designated as Preferred Stock, par value $1.00 per share.

The following is a statement of the designations, preferences, limitations, and relative rights, including voting rights, in respect of the classes of stock of the corporation and of the authority with respect thereto expressly vested in the board of directors of the corporation:

A. <u>COMMON STOCK</u>

1. Each share of Common Stock of the corporation shall have identical rights and privileges in every respect. The holders of shares of Common Stock shall be entitled to vote upon all matters submitted to a vote of the shareholders of the corporation and shall be entitled to one vote for each share of Common Stock held.

2. Subject to the prior rights and preferences, if any, applicable to shares of the Preferred Stock or any series thereof, the holders of shares of the Common Stock shall be entitled to receive such dividends (payable in cash, stock, or otherwise) as may be declared thereon by the board of directors at any time and

from time to time out of any funds of the corporation legally available therefor.

3. In the event of any voluntary or involuntary liquidation, dissolution, or winding-up of the corporation, after distribution in full of the preferential amounts, if any, to be distributed to the holders of shares of the Preferred Stock or any series thereof, the holders of shares of the Common Stock shall be entitled to receive all of the remaining assets of the corporation available for distribution to its shareholders, ratably in proportion to the number of shares of the Common Stock held by them. A liquidation, dissolution, or winding-up of the corporation, as such terms are used in this Paragraph 3, shall not be deemed to be occasioned by or to include any merger of the corporation with or into one or more corporations or other entities, any acquisition or exchange of the outstanding shares of one or more classes or series of the corporation, or any sale, lease, exchange, or other disposition of all or a part of the assets of the corporation.

B. <u>PREFERRED STOCK</u>

1. Shares of the Preferred Stock may be issued from time to time in one or more series, the shares of each series to have such designations, preferences, limitations, and relative rights, including voting rights, as shall be stated and expressed herein or in a resolution or resolutions providing for the issue of such series adopted by the board of directors of the corporation. Each such series of Preferred Stock shall be designated so as to distinguish the shares thereof from the shares of all other series and classes. The board of directors of the corporation is hereby expressly authorized, subject to the limitations provided by law, to establish and designate series of the Preferred Stock, to fix the number of shares constituting each series, and to fix the designations and the preferences, limitations, and relative rights, including voting rights, of the shares of each series and the variations of the relative rights and preferences as between series, and to increase and to decrease the number of shares constituting each series, provided that the board of directors may not decrease the number of shares within a series to less than the number of shares within such series that are then issued. The relative powers, rights, preferences, and limitations may vary between and among series of Preferred Stock in any and all respects so long as all shares of the same series are identical in all respects, except that shares of any such series issued at different times may have different dates from which dividends thereon cumulate. The authority of the board of directors of the corporation with respect to each series shall include, but shall not be limited to, the authority to determine the following:

(a) The designation of such series;

(b) The number of shares initially constituting such series;

(c) The rate or rates and the times at which dividends on the shares of such series shall be paid, the periods in respect of which dividends are payable, the conditions upon such dividends, the relationship and preferences, if any, of such dividends to dividends payable on any other class or series of shares, whether or not such dividends shall be cumulative, partially cumulative, or noncumulative, if such dividends shall be cumulative or partially cumulative, the date or dates from and after which, and the amounts in which, they shall accumulate, whether such dividends shall be share dividends, cash or other dividends, or any combination thereof, and if such dividends shall include share dividends, whether such share dividends shall be payable in shares of the same or any other class or series of shares of the corporation (whether now or hereafter authorized), or any combination thereof, and the other terms and conditions, if any, applicable to dividends on shares of such series;

(d) Whether or not the shares of such series shall be redeemable or subject to repurchase at the option of the corporation or the holder thereof or upon the happening of a specified event, if such shares shall be redeemable, the terms and conditions of such redemption, including but not limited to the date or dates upon or after which such shares shall be redeemable, the amount per share which shall be payable upon such redemption, which amount may vary under different conditions and at different redemption dates, and whether such amount shall be payable in cash, property, or rights, including securities of the corporation or another corporation;

(e) The rights of the holders of shares of such series (which may vary depending upon the circumstances or nature of such liquidation, dissolution, or winding up) in the event of the voluntary or involuntary liquidation, dissolution, or winding up of the corporation and the relationship or preference, if any, of such rights to rights of holders of stock of any other class or series. A liquidation, dissolution, or winding up of the corporation, as such terms are used in this subparagraph (e), shall not be deemed to be occasioned by or to include any merger of the corporation with or into one or more corporations or other entities, any acquisition or exchange of the outstanding shares of one or more classes or series of the corporation, or any sale, lease, exchange, or other disposition of all or a part of the assets of the corporation;

(f) Whether or not the shares of such series shall have voting powers and, if such shares shall have such voting powers, the terms and conditions thereof, including, but not limited to, the right of the holders of such shares to vote as a separate class either alone or with the holders of shares of one or more other classes or series of stock and the right to have more (or less) than one vote per share;

(g) Whether or not a sinking fund shall be provided for the redemption of the shares of such series and, if such a sinking fund shall be provided, the terms and conditions thereof;

(h) Whether or not a purchase fund shall be provided for the shares of such series and, if such a purchase fund shall be provided, the terms and conditions thereof;

(i) Whether or not the shares of such series, at the option of either the corporation or the holder or upon the happening of a specified event, shall be convertible into stock of any other class or series and, if such shares shall be so convertible, the terms and conditions of conversion, including, but not limited to, any provision for the adjustment of the conversion rate or the conversion price;

(j) Whether or not the shares of such series, at the option of either the corporation or the holder or upon the happening of a specified event, shall be exchangeable for securities, indebtedness, or property of the corporation and, if such shares shall be so exchangeable, the terms and conditions of exchange, including, but not limited to, any provision for the adjustment of the exchange rate or the exchange price; and

(k) Any other preferences, limitations, and relative rights as shall not be inconsistent with the provisions of this Article IV or the limitations provided by law.

2. Except as otherwise required by law or in any resolution of the board of directors creating any series of Preferred Stock, the holders of shares of Preferred Stock and all series thereof who are entitled to vote shall vote together with the holders of shares of Common Stock, and not separately by class.

C. <u>GENERAL</u>

1. The board of directors of the corporation is hereby expressly empowered, subject to the limitations provided by law, to authorize the corporation to pay share dividends on any class or series of capital stock of the corporation (whether now or hereafter authorized) payable in shares of the same or any other

class or series of capital stock of the corporation (whether now or hereafter authorized) or any combination thereof.

ARTICLE III

The number of shares of the Corporation's stock outstanding at the time of such adoption was 615,861 and the number of shares entitled to vote thereon was 615,861.

ARTICLE IV

The holders of all of the outstanding shares of the Corporation's stock entitled to vote on the amendment have signed a written consent pursuant to Article 9.10.A of the TBCA adopting the amendment. Said consent is dated January 3, 1995.

Dated: January 5, 1995

GATEWAY TECHNOLOGIES, INC.

By: Richard E. Cree

Richard E. Cree
President

STATEMENT OF DESIGNATIONS, PREFERENCES, LIMITATIONS AND RELATIVE RIGHTS OF SERIES A CONVERTIBLE PREFERRED STOCK

Pursuant to Article 2.13 of the
Texas Business Corporation Act

The undersigned President of Gateway Technologies, Inc., a Texas corporation (the "Corporation"), certifies that pursuant to authority granted to and vested in the Board of Directors of the Corporation by the provisions of the Articles of Incorporation of the Corporation, as amended, and in accordance with the provisions of Article 2.13 of the Business Corporation Act of the State of Texas, its Board of Directors on January 12, 1995, duly adopted the following resolutions creating the Series A Convertible Preferred Stock:

WHEREAS, the Board of Directors of the Corporation is authorized, within the limitations and restrictions stated in the Articles of Incorporation of the Corporation, as amended, to fix by resolution or resolutions the designation of each series of stock and the preferences, limitations, and relative rights, including voting rights, and qualifications, limitations, or restrictions thereof, including, without limiting the generality of the foregoing, such provisions as may be desired concerning voting, redemption, dividends, dissolution, or the distribution of assets, conversion or exchange, and such other subjects or matters as may be fixed by resolution or resolutions of the Board of Directors under the Business Corporation Act of the State of Texas; and

WHEREAS, it is the desire of the Board of Directors of the Corporation, pursuant to its authority as aforesaid, to authorize and fix the terms of a series of preferred stock and the number of shares constituting such series;

NOW, THEREFORE, BE IT RESOLVED, that one series of preferred stock is hereby authorized on the terms and with the provisions herein set forth:

1. Designation, Number of Shares and Stated Value. The designation of the series of preferred stock authorized by this resolution shall be "Series A Convertible Preferred Stock," which shall consist of 30,000 shares of such Series A Convertible Preferred Stock, $1.00 par value per share. As used herein, "Stated Value" per share of Series A Convertible Preferred Stock shall be equal to $20.00 plus all accumulated and unpaid dividends added thereto pursuant to Section 2 hereof. Each share of Series A Convertible Preferred Stock shall be validly issued, fully paid and nonassessable upon receipt by the Corporation of legal consideration in an amount determined by the Board of Directors of the Corporation to be at least equal to such Stated Value.

2. Dividends

(a) 6% Dividend. The holders of shares of Series A Convertible Preferred Stock shall be entitled to receive, out of the funds of the Corporation legally available therefor, if, as and when declared by the Board of Directors, cash dividends at the rate of 6% per share per annum, on the face value thereof, accruing from February 28, 1995, payable quarterly on the last day of the months of February, May, August, and November in each year, commencing May 31, 1995, except that if such date is a Saturday, Sunday or legal holiday then such dividend shall be payable on the first immediately preceding day which is not a Saturday, Sunday or legal holiday. Such dividends shall be cumulative (whether or not in any quarterly dividend period there shall be funds of the Corporation legally available for the payment of such dividends), commencing on the date of original issue and shall be payable for any period less than a full quarter on the basis of a year of 360 days with equal 30 day months. Dividends shall be payable to holders of record, as they appear on the stock books of the Corporation, on such record dates as may be declared by the Board of Directors, not more than sixty (60) days nor less than ten (10) days preceding the payment dates for such dividends. Dividends in arrears may be declared and paid at any time, without reference to any regular dividend payment date, to holders of record on such date, not exceeding sixty (60) days preceding the payment date thereof, as may be fixed by the Board of Directors of the Corporation. When dividends are not paid in full upon the shares of the Series A Convertible Preferred Stock and any other preferred stock ranking on a parity as to payment of dividends with the Series A Convertible Preferred Stock ("Parity Stock"), all dividends declared upon shares of the Series A Convertible Preferred Stock and any Parity Stock shall be declared pro rata so that the amount of dividends declared per share on the Series A Convertible Preferred Stock and such Parity Stock shall in all cases bear to each other the same ratio that accumulated dividends per share on the shares of the Series A Convertible Preferred Stock and such Parity Stock bear to each other.

(b) Certain Restrictions on Payment. So long as any shares of the Series A Convertible Preferred Stock are outstanding and any dividends due and payable on the Series A Convertible Preferred Stock are in arrears, the Corporation shall not, without the prior written consent of a holder or the holders of more than fifty per cent of the issued and outstanding shares of Series A Convertible Preferred Stock, declare, pay or set apart for payment any dividend on any of the Junior Securities (hereinafter defined) or make any payment on account of, or set apart for payment money for a sinking or other similar fund for, the purchase, redemption or other retirement of any of the Junior Securities or any warrants, rights, calls or options exercisable for any of the Junior Securities, or make any distribution in respect thereof, either directly or indirectly, and whether in cash, obligations or shares of stock of the Corporation or other property, and shall not permit any corporation or other entity directly or indirectly controlled by the Corporation to redeem, purchase or otherwise acquire any equity security (other than the shares of the Corporation's common stock, par value $1.00 per share ("Common Stock"), into which the Series A Convertible Preferred Stock is convertible) of the Corporation (or any non-wholly owned subsidiary of the Corporation); provided, however, that the Corporation shall be permitted to repurchase (i) shares of the Common Stock of the Corporation held by employees, consultants, officers, or directors pursuant to the terms of any restrictive stock purchase arrangements under which the Corporation has the option or obligation to repurchase such shares upon the occurrence of certain events such as termination of employment or failure to serve as a director and (ii) shares of the Series A Convertible Preferred Stock pursuant to the terms of this Statement of Designations, Preferences, Limitations and Relative Rights of Series A Convertible Preferred Stock.

3. Liquidation Preference.

In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Corporation, the holders of shares of the Series A Convertible Preferred Stock then outstanding shall be entitled to be paid out of the assets of the Corporation available for distribution to its stockholders an amount of cash equal to the greater of (a) the amount per share that holders of Series A Convertible Preferred Stock would be entitled to receive if all of their shares of Series A Convertible Preferred Stock were converted into Common Stock at the time of such liquidation, dissolution or winding up or (b) the Stated Value of the Series A Convertible Preferred Stock at the time of such liquidation, dissolution or winding up, and no more, before any payment shall be made or any assets distributed to the holders of any of the Junior Securities; provided, however, that the holders of the outstanding shares of Series A Convertible Preferred Stock shall not be entitled to receive such liquidation payment until the liquidation payments on all outstanding shares of any other stock of the Corporation having liquidation rights ranking prior to the shares of Series A Convertible Preferred Stock shall have been paid in full. If the assets of the Corporation are not sufficient to pay in full the liquidation payments payable to the holders of outstanding shares of Series A Convertible Preferred Stock and any outstanding shares of any other stock of the Corporation having liquidation rights on parity with the shares of the Series A Convertible Preferred Stock, then the holders of all such shares shall share ratably in such distribution of assets in accordance with the amount which would be payable on such distribution if the amounts to which the holders of outstanding shares of Series A Convertible Preferred Stock and the holders of outstanding shares of such other stock of the Corporation are entitled were paid in full. A merger of or by the Corporation or sale of all or substantially all assets of the Corporation shall not be deemed to be a liquidation, dissolution or winding up of the Corporation.

4. Ranking.

The Series A Convertible Preferred Stock shall, with respect to dividend rights and distribution of assets on liquidation, rank (a) junior to, or on parity with, as the case may be, any other stock of the Corporation, the terms of which shall specifically provide that such stock shall rank senior to, or on parity with, as the case may be, the Series A Convertible Preferred Stock with respect to dividend rights or distribution of assets on liquidation, and (b) senior to any other stock of the Corporation, including the Common Stock (all of such stock of the Corporation to which the Series A Convertible Preferred Stock ranks prior, including the Common Stock, being referred to collectively for purposes of this Agreement as the "Junior Securities").

5. Voting Rights. Except as otherwise required by the Corporation's Articles of Incorporation (as amended), Bylaws, the Texas Business Corporation Act or any other applicable law, the holders of the Series A Convertible Preferred Stock shall not have any voting rights with respect to any matter.

6. Take-along Rights. In the event there is a bona fide offer from a third party to acquire more than fifty per cent of the then outstanding shares of voting securities of the Corporation, or to acquire control of the Corporation by other means, each holder of the Series A Convertible Preferred Stock shall have the right to convert all but not less than all of his or her shares of Series A Convertible Preferred Stock into Common Stock at the conversion rate of one share of Common Stock for each share of Series A Convertible Preferred Stock (the "Converted Shares") and require the Selling Shareholders (herein so called) to condition their acceptance of the offer on the offeror's agreement simultaneously (a) to acquire the same proportion of the Converted Shares on the same terms and conditions applicable to the acquisition of the Selling Shareholders' shares, and (b) to pay all accumulated dividends on the Series A Convertible Preferred Stock then in arrears.

7. Conversion Rights. On March 1, 1998, the holders of shares of Series A Convertible Preferred Stock shall have conversion rights as follows:

(a) Mandatory Conversion or Put Option. Each holder of the Series A Convertible Preferred Stock shall, within 60 days of but no later than 10 days before March 1, 1998, by written notice to the Secretary of the Corporation, elect either (i) to convert all of his, her or its shares of Series A Convertible Preferred Stock into the Corporation's Common Stock at the rate of one share of Common Stock for each share of Series A Convertible Preferred Stock (the "Conversion Option"), or (ii) to demand that the Corporation repurchase all of his, her or its shares of Series A Convertible Preferred Stock at the Stated Value per share (the "Redemption Option"), the election of either (i) or (ii) above by the holder or holders of the Series A Convertible Preferred Stock being mandatory and, once made as provided above, irrevocable. A holder of the Series A Convertible Preferred Stock who does not provide the written election described in the preceding sentence shall be deemed to have elected the Conversion Option. The Corporation shall undertake to prepare, authorize and issue all such Common Stock to be issued in connection with shares subject to the Conversion Option and to arrange for the payment for the shares subject to the Redemption Option, and shall cause such payment or conversion to be made at the expense of the Corporation not later than March 15, 1998.

(b) Taxes. The Corporation will pay any documentary stamp and similar taxes (other than income taxes and ad valorem taxes) that may be payable in respect to any issue or delivery of shares of Common Stock on conversion of the Series A Convertible Preferred Stock pursuant hereto. The Corporation shall not, however, be required to pay any tax which may be payable in respect to any transfer involved in the issue and delivery of shares of Common Stock in a name other than that in which the Series A Convertible Preferred Stock so converted was registered, and no such issue or delivery shall be made unless and until the person requesting such issue or delivery has paid to the Corporation the amount of any such tax, or has established, to the satisfaction of the Corporation, that such tax has been paid. To the extent any tax is payable upon redemption, such tax is the responsibility of the shareholder.

8. Notices of Record Date. The Corporation shall mail by first class mail or recognized courier service to the holders of the Series A Convertible Preferred Stock at their last known address shown on the stockbook of the Corporation a notice in the event that the Corporation shall propose at any time to do any of the following:

(a) to declare any dividend or distribution upon the Common Stock or the Series A Convertible Preferred Stock, whether in cash, property, stock or securities, whether or not a regular cash dividend and whether or not out of earnings or surplus;

(b) to offer for subscription pro rata to the holders of any class or series of its stock any additional shares of stock of any class or series or other rights;

(c) to effect any reclassification or recapitalization of the Common Stock or the Series A Convertible Preferred Stock outstanding involving a change in the Common Stock or the Series A Convertible Preferred Stock, respectively; or

(d) to merge or consolidate with or into any other corporation, or sell, lease or convey all or substantially all its property or business, or to liquidate, dissolve or wind up.

Notice of an event described in parts (b), (c), and (d) above shall be sent to the holders of the Series A Convertible Preferred Stock at least twenty days prior to the date on which a record shall be taken in connection with such event.

9. Amendment. Except as may otherwise be required by the laws of the State of Texas, the provisions of this Statement may be amended or compliance by the Corporation herewith waived only by the affirmative vote or written consent of a holder or the holders of more than fifty percent of the issued and outstanding shares of Series A Convertible Preferred Stock.

IN WITNESS WHEREOF, the undersigned have executed this Statement on behalf of the Corporation as of the 13th day of January 1995.

GATEWAY TECHNOLOGIES, INC.

Name: Richard E. Cree
Title: President

The State of Texas

SECRETARY OF STATE

CERTIFICATE OF AMENDMENT

OF

GATEWAY TECHNOLOGIES, INC.

FORMERLY: TELEPHONE MANAGEMENT SYSTEMS, INC.

The undersigned, as Secretary of State of the State of Texas, hereby certifies that the attached Articles of Amendment, duly signed, have been received in this Office and are found to conform to law.

ACCORDINGLY the undersigned, as such Secretary of State, and by virtue of the authority vested in the Secretary by law, issues this Certificate and attaches hereto a copy.

Dated NOVEMBER 22, 19 99

George S Bayoud Jr.

Secretary of State

yd

LSM-AM(STK)

The State of Texas

Secretary of State

OCT. 2, 1989

GERALD G BYBEE
1500 AMARILLO NATIONAL BK BLDG BOX 9158
AMARILLO , TX 79105

RE:
TELEPHONE MANAGEMENT SYSTEMS, INC.
CHARTER NUMBER 01055484-00

IT HAS BEEN OUR PLEASURE TO APPROVE AND PLACE ON RECORD YOUR ARTICLES OF AMENDMENT. THE APPROPRIATE EVIDENCE IS ATTACHED FOR YOUR FILES. AND THE ORIGINAL HAS BEEN FILED IN THIS OFFICE.

PAYMENT OF THE FILING FEE IS ACKNOWLEDGED BY THIS LETTER.

IF WE CAN BE OF FURTHER SERVICE AT ANY TIME, PLEASE LET US KNOW.

VERY TRULY YOURS,

THE STATE OF TEXAS

Secretary of State

LSM-AM(STK)

The State of Texas

Secretary of State

CERTIFICATE OF AMENDMENT

FOR

TELEPHONE MANAGEMENT SYSTEMS, INC.
CHARTER NUMBER 01055484

THE UNDERSIGNED, AS SECRETARY OF STATE OF THE STATE OF TEXAS, HEREBY CERTIFIES THAT ARTICLES OF AMENDMENT HAVE BEEN RECEIVED IN THIS OFFICE AND ARE FOUND TO CONFORM TO LAW.

ACCORDINGLY THE UNDERSIGNED, AS SUCH SECRETARY OF STATE, AND BY VIRTUE OF THE AUTHORITY VESTED IN THE SECRETARY BY LAW, ISSUES THIS CERTIFICATE AND ATTACHES HERETO A COPY OF THE ARTICLES OF AMENDMENT.

DATED OCT. 2, 1989

Secretary of State

FILED
In the Office of the
Secretary of State of Texas

OCT 2 1989

Corporations Section

ARTICLES OF AMENDMENT TO THE ARTICLES OF INCORPORATION OF TELEPHONE MANAGEMENT SYSTEMS, INC.

Pursuant to the provisions of Article 4.04 of the Texas Business Corporation Act, the undersigned corporation adopts the following Articles of Amendment to its Articles of Incorporation:

ARTICLE I

The name of the corporation is TELEPHONE MANAGEMENT SYSTEMS, INC.

ARTICLE II

The following amendment to the Articles of Incorporation was adopted by the shareholders of the corporation on the 28th day of September, 1989. Article IV of the Articles of Incorporation is amended to read as follows:

> The aggregate number of shares which the corporation shall have the authority to issue is one million (1,000,000) at a par value of One dollar ($1.00) per share, of which 26,358 shares shall be issued in exchange for 300 shares of the currently issued and outstanding no par shares of the corporation, said currently outstanding shares being all of the currently issued and outstanding shares of the corporation.

The amendment alters or changes Article IV of the original Articles of Incorporation. The full text of Article IV prior to this amendment stated as follows:

> The aggregate number of shares which the corporation shall have authority to issue is 1,000 at no par value.

ARTICLE III

The number of shares of the corporation outstanding at the time of such adoption was 300; and the number of shares entitled to vote thereon was 300.

ARTICLE IV

The holders of all of the shares outstanding and entitled to vote on said amendment have signed a consent in writing adopting said amendment.

ARTICLE V

The manner in which any exchange, reclassification, or cancellation of issued shares provided for in the amendment shall be affected, is as follows:

> 26,358 shares of the newly authorized $1.00 par value shares of the corporation shall be issued in exchange for the currently issued and outstanding shares of the corporation in the ratio of 87.86 new shares for each currently outstanding share.

ARTICLE VI

The stated capital of the corporation will be increased by the amendment from $1,200.00 to $26,358.00, an increase of $24,980.00. Capital surplus will be reduced by $24,980.00.

DATED this 28th day of September, 1989.

TELEPHONE MANAGEMENT SYSTEMS, INC.

By Harold H. Carr
Its Authorized Officer

The State of Texas

SECRETARY OF STATE

CERTIFICATE OF INCORPORATION

OF

TELEPHONE MANAGEMENT SYSTEMS, INC.

CHARTER NO. 1055484

The undersigned, as Secretary of State of Texas, hereby certifies that Articles of Incorporation for the above corporation duly signed pursuant to the provisions of the Texas Business Corporation Act, have been received in this Office and are found to conform to law.

ACCORDINGLY the undersigned, as such Secretary of State, and by virtue of the authority vested in the Secretary by law, hereby issues this Certificate of Incorporation and attaches hereto a copy of the Articles of Incorporation.

Issuance of this Certificate of Incorporation does not authorize the use of a corporate name in this State in violation of the rights of another under the federal Trademark Act of 1946, the Texas trademark law, the Assumed Business or Professional Name Act, or the common law.

Dated FEB. 11, 19 88.

THE STATE OF TEXAS

Jack M Rains

Secretary of State

ceb

ARTICLES OF INCORPORATION
OF
TELEPHONE MANAGEMENT SYSTEMS, INC.

FILED
In the Office of the
Secretary of State of Texas

FEB 11 1988

Clerk I-B
Corporations Section

ARTICLE I

The name of the corporation is TELEPHONE MANAGEMENT SYSTEMS, INC.

ARTICLE II

The period of its duration is perpetual.

ARTICLE III

The purpose or purposes for which the corporation is organized are:

The transaction of any or all lawful business for which corporations may be incorporated under this act, subject to Part Four, Texas Miscellaneous Corporation Act.

ARTICLE IV

The aggregate number of shares which the corporation shall have authority to issue is 1,000 at no par value.

ARTICLE V

The corporation will not commence business until it has received for the issuance of its shares consideration of the value of $1,000.

ARTICLE VI

The address of its registered office is 408 West Kingsmill, Suite 322, Pampa, Tx. 79065, and the name of its registered agent at such address is Harold A. Cree.

ARTICLE VII

The number of initial directors is three, and the names and addresses of the directors are:

George B. Cree, III	408 W. Kingsmill, Ste. 322 Pampa, Tx. 79065
Richard E. Cree	408 W. Kingsmill, Ste. 322 Pampa, Tx. 79065
Harold A. Cree	408 W. Kingsmill, Ste. 322 Pampa, Tx. 79065
Amber Cree	408 W. Kingsmill, Ste. 322 Pampa, Tx. 79065

ARTICLE VIII

The name and address of the incorporator is:

Carol Hines	1601 Rio Grande, Ste. 351 Austin, Tx. 78701

Carol Hines

EXHIBIT B - CERTIFICATE OF AUTHORITY

State of South Dakota

OFFICE OF THE SECRETARY OF STATE

Certificate of Authority

I, JOYCE HAZELTINE, Secretary of State of the State of South Dakota, hereby certify that the Application for a Certificate of Authority of **T-NETIX TELECOMMUNICATIONS SERVICES, INC. (TX)** to transact business in this state duly signed and verified pursuant to the provisions of the South Dakota Corporation Acts, have been received in this office and are found to conform to law.

ACCORDINGLY and by virtue of the authority vested in me by law, I hereby issue this Certificate of Authority and attach hereto a duplicate of the application to transact business in this state.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the Great Seal of the State of South Dakota, at Pierre, the Capital, this July 13, 2000.

Joyce Hazeltine

Joyce Hazeltine
Secretary of State

SECRETARY OF STATE
STATE CAPITOL
500 E. CAPITOL
PIERRE, S.D. 57501-5077
605-773-4845
FAX (605) 773-4550

FILE NO. ______
RECEIPT NO. ______ RECEIVED

JUL 1 3 20[illegible]

APPLICATION FOR CERTIFICATE OF AUTHORITY

Filed this 13th day of July, 2000 ... Secretary of State

Pursuant to the provisions of SDCL 47-8-7, the undersigned corporation hereby applies for a Certificate of Authority to transact business in the State of South Dakota and for that purpose submits the following statement:

(1) The name of the corporation is T-NETIX Telecommunications Services, Inc.
(Exact corporate name)

(2) If the name of the corporation does not contain the word "corporation", "company", "incorporated" or "limited", or does not contain an abbreviation of one of such words, then the name of the corporation with the word or abbreviation which it elects to add thereto for use in this state is ______

(3) State where incorporated Texas Federal Taxpayer ID# ______

(4) The date of its incorporation is February 11, 1988 and the period of its duration, which may be perpetual, is Perpetual

(5) The address of its principal office in the state or country under the laws of which it is incorporated is

1544 Valwood Pkwy., Ste. 102, Carrollton, Texas Zip Code 75006

mailing address if different from above is: Same

______ Zip Code ______

(6) The street address, or a statement that there is no street address, of its proposed registered office in the State of South Dakota is c/o C T Corporation System, 319 S. Coteau Street, Pierre, South Dakota Zip 57501
and the name of its proposed registered agent in the State of South Dakota at that address is

C T Corporation System

(7) The purposes which it proposes to pursue in the transaction of business in the State of South Dakota are: (state specific purpose) Provider of automated telecommunication services to correctional facilities.

(8) The names and respective addresses of its directors and officers are:

Name	Officer Title	Street Address	City	State	Zip
See attached list of directors and					

(9) The aggregate number of shares which it has authority to issue, itemized by classes, par value of shares, shares without par value, and series, if any, within a class is:

Number of shares	Class	Series	Par value per share or statement that shares are without par value
1,000,000	Common	(No series)	$1.00

(S. D. - 258 - 7/19/97)CT System

(10) The aggregate number of its issued shares, itemized by classes, par value of shares, shares without par value, and series, if any, within a class, is:

Number of shares	Class	Series	Par value per share or statement that shares are without par value
729,004	Common	(No series)	$1.00

(11) The amount of its stated capital is $729,004.00
Shares issued times par value equals stated capital. In the case of no par value stock, stated capital is the consideration received for the issued shares.

(12) This application is accompanied by a CERTIFICATE OF FACT or a CERTIFICATE OF GOOD STANDING duly acknowledged by the secretary of state or other officer having custody of corporate records in the state or country under whose laws it is incorporated.

(13) That such corporation shall not directly or indirectly combine or make any contract with any incorporated company, foreign or domestic, through their stockholders or the trustees or assigns of such stockholders, or with any copartnership or association of persons, or in any manner whatever to fix the prices, limit the production or regulate the transportation of any product or commodity so as to prevent competition in such prices, production or transportation or to establish excessive prices therefor.

(14) That such corporation, as a consideration of its being permitted to begin or continue doing business within the State of South Dakota, will comply with all the laws of the said State with regard to foreign corporations.

The application must be signed, in the presence of a notary public, by the chairman of the board of directors, or by the president or by another officer.

I DECLARE AND AFFIRM UNDER THE PENALTY OF PERJURY THAT THIS APPLICATION IS IN ALL THINGS TRUE AND CORRECT.

Dated 7/5 ~~19~~2000

(Signature) Richard E. Cree

President
(Title)

State of Texas
County of Dallas

On this 5TH day of JULY , 192000, before me Sharon Turner
personally appeared Richard E. Cree known to me, or proved to me, to be the President of the corporation that is described in and that executed the within instrument and acknowledged to me that such corporation executed same.

My Commission Expires: 10/27/...

(Notary Public)

Notarial Seal

SHARON TURNER NOTARY PUBLIC STATE OF TEXAS

****

The Consent of Appointment below must be signed by the registered agent listed in number six.

CONSENT OF APPOINTMENT BY THE REGISTERED AGENT

I, C T Corporation System, hereby give my consent to serve as the
(name of registered agent)

registered agent for T-NETIX Telecommunications Services, Inc.
(corporate name)

Dated 7/12 ~~19~~ 200

C T CORPORATION SYSTEM
By:
(signature of registered agent) Michael D. Reed
Assistant Secretary

T-NETIX TELECOMMUNICATIONS SERVICES, INC.

OFFICERS & BOARD OF DIRECTORS

Richard E. Cree, President and Director
1544 Valwood Pkwy., Suite 102
Carrollton, Texas 75006

Alvyn A. Schopp, Vice President and Director
2348 E. Millcreek Place
Highlands Ranch, Colorado 80126

Nancy K. Lee, Vice President and Secretary
1544 Valwood Pkwy., Suite 102
Carrollton, Texas 75006

John Giannaula, Vice President and Assistant Secretary
7811 S. Garfield Way
Littleton, Colorado 80122

EXHIBIT C - MARKETING MATERIAL
Not Available

EXHIBIT D - FINANCIAL INFORMATION

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
T-NETIX, Inc.:

We have audited the accompanying consolidated balance sheets of T-NETIX, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of T-NETIX, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999, in conformity with generally accepted accounting principles.

KPMG LLP

Denver, Colorado
March 21, 2000

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
ASSETS		
Cash and cash equivalents	$ 118	$ 678
Accounts receivable, net (note 2)	16,868	16,489
Prepaid expenses	1,038	1,023
Inventories	710	269
Total current assets	18,734	18,459
Property and equipment, net (note 2)	33,858	31,498
Goodwill, net	6,401	5,824
Deferred tax asset	2,297	962
Intangible and other assets, net (note 2)	9,252	8,736
Total assets	$ 70,542	$65,479
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$ 11,914	$ 4,688
Accrued liabilities (note 2)	7,606	5,677
Debt (note 5)	7,366	21,353
Total current liabilities	26,886	31,718
Long term debt (note 5)	21,555	4,157
Total liabilities	48,441	35,875
Stockholders' equity (note 6):		
Preferred stock, $.01 stated value, 10,000,000 shares authorized; no shares issued	—	—
Common stock, $.01 stated value, 70,000,000 shares authorized; 12,699,400 and 12,225,634 shares issued and outstanding at December 31, 1999 and 1998, respectively	127	122
Additional paid-in capital	35,791	33,052
Accumulated deficit	(13,817)	(3,570)
Total stockholders' equity	22,101	29,604
Commitments and contingencies (note 9)		
Total liabilities and stockholders' equity	$ 70,542	$65,479

See accompanying notes to consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	1999	1998	1997
	(amounts in thousands, except per share amounts)		
Revenue:			
Telecommunications services	$ 39,274	$43,089	$39,616
Direct call provisioning	27,517	22,736	19,051
Equipment sales and other	6,444	2,416	3,638
Total revenue	73,235	68,241	62,305
Expenses:			
Operating costs and expenses:			
Telecommunications services	17,674	17,014	15,262
Direct call provisioning	25,032	20,048	16,462
Cost of equipment sold and other	3,615	848	1,298
Total operating costs and expenses	46,321	37,910	33,022
Selling, general and administrative	13,794	13,401	11,816
Research and development	5,078	3,936	3,554
Impairment of telecommunications assets	4,632	—	—
Depreciation and amortization	11,620	10,174	9,546
Total expenses	81,445	65,421	57,938
Operating income (loss)	(8,210)	2,820	4,367
Merger transaction expenses	(1,017)	—	—
Interest and other income (expense), net	(2,137)	(2,354)	(1,583)
Earnings (loss) before income taxes	(11,364)	466	2,784
Income tax benefit (expense) (note 8)	1,117	(196)	(1,039)
Net earnings (loss)	$(10,247)	$ 270	$ 1,745
Basic earnings (loss) per common share	$ (0.82)	$ 0.02	$ 0.15
Diluted earnings (loss) per common share	$ (0.82)	$ 0.02	$ 0.13
Weighted average common shares — basic	12,511	12,172	11,909
Weighted average common shares — diluted	12,511	12,930	12,988

See accompanying notes to consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount			
			(amounts in thousands)		
Balances at January 1, 1997	11,505	$ 115	$ 30,130	$ (3,279)	$ 26,966
Common stock issued upon exercise of stock options	155	2	204	—	206
Common stock issued in business acquisition	8	—	94	—	94
Common stock issued for cash	202	2	598	—	600
Dividends paid to preferred stockholders	—	—	—	(36)	(36)
Tax benefit from stock options exercised (note 8)	—	—	402	—	402
Net earnings	—	—	—	1,745	1,745
Balances at December 31, 1997	11,870	119	31,428	(1,570)	29,977
Common stock issued upon exercise of stock options	230	2	819	—	821
Conversion of preferred stock	149	1	592	—	593
Purchase of treasury stock	(32)	—	(98)	(26)	(124)
Stock compensation	—	—	75	—	75
Dividends paid to preferred stockholders	—	—	—	(9)	(9)
Tax benefit from stock options exercised (note 8)	—	—	198	—	198
Adjustments to conform year ends of combined companies	9	—	38	(2,235)	(2,197)
Net earnings	—	—	—	270	270
Balances at December 31, 1998	12,226	122	33,052	(3,570)	29,604
Common stock issued upon exercise of stock options	98	1	256	—	257
Common stock issued for intangible asset (note 3)	375	4	2,483	—	2,487
Net loss	—	—	—	(10,247)	(10,247)
Balances at December 31, 1999	12,699	$ 127	$ 35,791	$(13,817)	$ 22,101

See accompanying notes to consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1999	1998	1997
	(amounts in thousands)		
Cash flows from operating activities:			
Net earnings (loss)	$(10,247)	$ 270	$ 1,745
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	11,620	10,174	9,546
Impairment loss and investment write-off	4,632	600	—
Deferred income tax expense (benefit)	(1,117)	15	570
Loss (gain) on sale of property and equipment	(206)	(83)	6
Stock compensation expense	—	75	—
Changes in operating assets and liabilities:			
Change in accounts receivable, net	(263)	1,680	(5,306)
Change in prepaid expenses	(48)	(678)	(146)
Change in inventory	(441)	(164)	15
Change in intangibles and other assets	(593)	(227)	(371)
Change in accounts payable	6,972	(549)	(4,834)
Change in accrued liabilities	1,907	(670)	1,356
Cash provided by operating activities	12,216	10,443	2,581
Cash used in investing activities:			
Capital expenditures	(14,560)	(6,190)	(9,061)
Acquisition of business or business assets	(1,377)	(2,679)	(175)
Proceeds from disposal or property and equipment	473	121	13
Other investing activities	(980)	(2,460)	(1,208)
Cash used in investing activities	(16,444)	(11,208)	(10,431)
Cash flows from financing activities:			
Net proceeds (payments) under line of credit	11,489	(2,318)	6,765
Payments of debt	(8,078)	(3,064)	(3,396)
Proceeds from debt	—	5,731	3,722
Common stock issued for cash under option plans	257	821	206
Common stock issued for cash	—	—	600
Treasury stock purchased	—	(124)	—
Dividends on preferred stock	—	(9)	(36)
Redemption on preferred stock	—	(7)	—
Cash provided by (used in) financing activities	3,668	1,030	7,861
Net increase (decrease) in cash and cash equivalents	(560)	265	11
Adjustment to conform year ends of combined companies	—	48	—
Cash and cash equivalents at beginning of year	678	365	354
Cash and cash equivalents at end of year	$ 118	$ 678	$ 365
Cash paid for interest	$ 2,568	$ 1,773	$ 1,502
Cash paid for income taxes	$ 217	$ 622	$ 95

See accompanying notes to consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1999 and 1998

(1) Summary of Significant Accounting Policies

General

T-NETIX, Inc. and subsidiaries ("T-NETIX" or the "Company") was incorporated in Colorado in 1986. The Company has three reportable segments the Corrections Division, the Internet Services Division and the SpeakEZ Division ("SpeakEZ").

The Corrections Division primarily manages its specialized telecommunications hardware and software systems for long distance and local exchange carriers on a contractual basis. The long distance and local exchange carriers in turn pay a fee per call to the Company for each billable call made from a phone subject to a contract with the Company. The Company also receives revenue from billing collect calls made from correctional facilities in which the Company's specialized telecommunications hardware and software systems are located. The Internet Services Division provides interLATA Internet services to Internet subscribers and buys and resells Internet bandwidth. SpeakEZ engages in the research and development and sales and marketing of speaker verification technology.

Basis of Presentation

On June 14, 1999, the Company completed a merger with Gateway Technologies, Inc. ("Gateway"), a privately held provider of inmate calling services. As a result of the merger, Gateway became a wholly owned subsidiary of the Company. Prior to the merger, the Company changed its year-end from July 31 to December 31. Gateway's year-end was December 31.

The merger was accounted for as a pooling of interests. As a result, the Company's financial statements have been restated to combine Gateway's financial statements as if the merger had occurred at the beginning of the earliest period presented. Information concerning common stock and per share data has been restated on an equivalent share basis.

The consolidated statements of operations and cash flows for the years ended December 31, 1998 and 1997 have been recast to reflect the results of operations and cash flows for T-NETIX for the years ended July 31, 1998 and 1997, respectively, combined with Gateway for the years ended December 31, 1998 and 1997.

As a result of T-NETIX and Gateway having different fiscal year ends prior to 1999, the results of operations of T-NETIX for the five month period ended December 31, 1998, have been excluded from the reported results of operations. The net loss for the period and common stock transactions during that period have been accounted for as an adjustment of stockholders' equity at January 1, 1999. T-NETIX had revenue, expenses, and net loss of $15,041,000, $17,606,000, and $2,235,000, respectively, for the five month period ended December 31, 1998.

Liquidity

The Company incurred losses from continuing operations in the current year of $10.2 million and had a working capital deficit of $8.2 million at December 31, 1999. The Company received a waiver from its lenders relating to various covenant violations on its bank credit facility. In connection with the waiver, the lenders agreed to revise the existing covenant requirements if the Company can raise $7 million of additional financing on or before April 14, 2000. The funds raised are required to be used to reduce the outstanding balance on the credit facility. These factors among others may indicate that the Company may not be able to meet its obligations as they become due or the Company may have to significantly reduce installations and curtail other operations.

(1) Summary of Significant Accounting Policies (continued)

The Company has taken steps to obtain the additional financing, on or before the deadline of April 14, 2000, by entering into term sheets to issue convertible preferred securities to a non-related party and subordinated debt instruments to one of the Company's directors. Management believes that they will complete the above financing arrangements in the time frame imposed by the lenders. Should the Company be unable to complete the financing arrangements or an alternative financing arrangement by the deadline currently imposed by the lenders, the Company would again be in breach of the loan agreement covenants and the lenders could commence immediate collection activity.

In addition, the Company is taking steps to increase cash flow from operations and obtain additional financing to ensure that the Company is able to carry out its fiscal 2000 business plan. There can be no assurance that the Company will be successful in increasing its cash flow from operations or that additional financing will be available, or if available, will be obtained on acceptable terms.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Risks and Uncertainties

A majority of the Company's revenue is generated from services provided to significant telecommunications customers. The loss of a major customer could affect operating results adversely.

Cash Equivalents

Cash equivalents consist of highly liquid investments, such as certificates of deposit and money market funds, with original maturities of 90 days or less.

Fair Value of Financial Instruments

The reported amounts of the Company's financial instruments including cash and cash equivalents, receivables, accounts payable, and accrued liabilities approximate fair value due to their short maturities. The reported amounts of debt approximate fair value due to market interest rates that these debts bear.

Concentrations of Credit Risk

Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's revenue is primarily concentrated in the United States in the telecommunications industry. The Company had trade accounts receivable from 5 customers that comprised 28% and 31% of total trade accounts receivable at December 31, 1999 and 1998, respectively. The Company does not require collateral on accounts receivable balances and provides allowances for potential credit losses. An allowance for doubtful accounts has been established based

(1) Summary of Significant Accounting Policies (continued)

on historical experience and management's evaluation of outstanding accounts receivable at the end of the accounting period.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values.

Property and Equipment

Property and equipment is stated at cost, including costs necessary to place such property and equipment in service. Major renewals and improvements are capitalized, while repairs and maintenance are charged to operations as incurred.

Construction in progress represents the cost of material purchases and construction costs, including interest capitalized during construction, for telecommunications hardware systems in various stages of completion. During the years ended December 31, 1999, 1998 and 1997, interest capitalized was insignificant.

Depreciation is computed on a straight-line basis using estimated useful lives of 3 to 7 years for telecommunications equipment and 5 to 10 years for office equipment. No depreciation is recorded on construction in progress until the asset is placed in service.

Intangible and Other Assets

Other assets include intellectual property assets, capitalized computer software, patent defense and application costs, deposits and long-term prepayments and other intangible assets. Patents and intangible assets are stated at cost. Amortization is computed on the straight-line basis over 17 years for patent costs and periods ranging from 3 to 7 years for other intangibles. Amortization charged to expense was $1,500,000, $936,000, and $796,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

Goodwill

Goodwill, representing the excess of the cost over the net tangible and identifiable assets of the acquired businesses, is stated at cost and is amortized, principally on a straight-line basis, over the estimated future periods to be benefited 5 to 10 years. On an annual basis, the Company reviews the recoverability of goodwill based primarily on an analysis of undiscounted cash flows from the acquired business. Accumulated amortization amounted to $1,103,000 and $364,000 at December 31, 1999 and 1998, respectively.

Impairment of Long-Lived Assets

The Company reviews its property and equipment and unamortized intangible assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company estimates the future cash flows expected to result from operations and if the sum of the expected undiscounted future cash flows is less than the carrying amount of the long-lived asset, the Company recognizes an impairment loss by reducing the unamortized cost of the long-lived asset to its estimated fair value.

During the year ended December 31, 1999, the Company recorded an impairment charge of telecommunications assets of $4,632,000. Impaired telecommunications assets consisted of software development costs, construction in progress, and inmate calling platform assets. Two events occurred in 1999 indicated that the carrying value of certain equipment and intangible assets may not be recoverable.

(1) Summary of Significant Accounting Policies (continued)

In September, 1999, the Company completed an evaluation of the future viability of its new inmate calling platform ("DL Platform") which it had been developing over the past two years. The merger with Gateway allowed the Company to consider an alternative to the DL Platform. The Company determined that the Gateway ComBridge Platform ("ComBridge"), would be the platform to install for both new customers and upgrades of existing customers. However, over the last year the Company had been awarded certain contracts where the DL Platform was to be deployed. Since the Company believes that it would not be cost effective to maintain and support two separate systems, the Company proceeded to renegotiate all existing contracts to install ComBridge instead of the DL Platform. During the quarter ended September 30, 1999, the Company successfully completed these negotiations. Due to the abandonment of the DL Platform, the Company no longer has any anticipated cash flow to support the carrying value of assets related to the DL Platform. Capitalized costs relating to the DL Platform included software development costs, components (consisting of primarily telephony cards) and other supporting computer peripheral equipment. The estimated impairment, being the excess of the carrying amounts over the respective estimated fair value of these assets, is approximately $3,669,000 for the year ended December 31, 1999. As a result, software development costs at December 31, 1999 were impaired by $2,093,000 and construction in progress relating to these products was impaired by $1,576,000. All of these charges are applicable to the Corrections Division.

In addition, the Company deployed a version of its old inmate calling platform that resides in its customer's network locations. The Company has recently experienced a reduction in call volumes and revenues for this platform. The customer has indicated to the Company that it does not intend to use the platform as a source of future services. Additionally, since the platform was based on the predecessor to the DL Platform, there is not an upgrade path available for the new platform. Any new feature or service offering would be evaluated based on the new ComBridge Platform. The reduction in call volumes caused the estimated fair value of these assets to be less than the existing book value. The Company estimated the fair value of these assets based on the discounted cash flows from each service location. After consideration of minimal salvage value of these assets due to their specific use, the Company recorded an impairment charge of approximately $963,000. This charge was applicable to the Corrections Division.

Revenue Recognition

Revenue and expenses from telecommunications services and direct call provisioning are recognized at the time the telephone call is completed. Provision is made for uncollectible accounts in the period direct call provisioning revenue is recorded. Revenue from equipment sales is recognized when the equipment is shipped to customers. Internet services are recognized as the services are provided. The Company records deferred revenue for advance billings to customers, or prepayments by customers prior to the completion of installation or prior to the provision of contractual bandwidth usage.

The Company recognizes revenue from the sale of computer software in accordance with the American Institute of Certified Public Accountants ("AICPA"), Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by Statement of Position 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2" ("SOP 98-4").

SOP 97-2 and SOP 98-4 generally require revenue earned on software arrangements involving multiple elements (i.e. software products, upgrades/enhancements, post contract customers support, installation, training , etc.) to be allocated to each element based on the relative fair value of the elements. The fair value of an element must be recognized upon delivery of the products. The revenue allocated to post contract customer support generally is recognized ratably over the term of the support and the revenue allocated to service elements (such as training and installation) generally is recognized as the services are performed. If a vendor does not have evidence of the fair value of all elements in a multiple-element arrangement, all revenue from the arrangement is deferred until such evidence exists or until all elements are delivered.

(1) Summary of Significant Accounting Policies (continued)

In December 1998, the AICPA issued Statement of Position 98-9, "Modification of 97-2, Software Revenue Recognition, With Respect to Certain Transactions" ("SOP 98-9"). SOP 98-9 requires the use of the "residual method" for recognition of revenue when vendor-specific objective evidence exists for undelivered elements but does not exist for delivered elements of a software arrangement. The Company will be required to comply with the provisions of SOP 98-9 for transactions entered into beginning January 1, 2000. The Company believes the adoption of SOP 98-9 will not have a material effect on its consolidated financial statements, results of operations or financial condition.

Research and Development

Costs associated with the research and development of new technology or significantly altering existing technology are charged to operations as incurred. Software development costs have been accounted for in accordance with Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed.* Under the standard, capitalization of software development costs begins upon the establishment of technological feasibility, subject to net realizable value considerations. Capitalized software costs are amortized over the economic useful life of the software product, which is generally estimated to be three years.

The American Institute of Certified Public Accountants ("AICPA") Statement of Position 98-1, "Accounting for the Costs of Computer Software Development or Obtained for Internal Use ("SOP 98-1") provides guidance for the accounting for computer software developed or obtained for internal use including the requirement to capitalize specified costs. There were no such costs capitalized pursuant to SOP 98-1 at December 31, 1999 and 1998.

401(k) Plan

The Company established a 401(k) plan for all of its full time employees effective January 1, 1994. In June 1998, the Company implemented a matching program. The program calls for the Company to match 25% of an employee's contribution up to 6% of the individual employee's total salary. Matching contributions and plan expenses were $111,000 for the year ended December 31, 1999 and were not significant for the year ended December 31, 1998.

Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in the results of operations in the period that includes the enactment date.

Earnings (Loss) Per Common Share

Earnings (loss) per common share are presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, *Earnings Per Share* (SFAS 128). Basic earnings per share excludes dilution for common stock equivalents and is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the year ended December 31, 1999,

(1) Summary of Significant Accounting Policies (continued)

375,000 common stock equivalents were not included in the diluted earnings per share calculation, as their effect would be anti-dilutive. For the years ended December 31, 1998 and 1997 diluted common and common equivalent shares outstanding includes 758,000 and 1,080,000, respectively of common share equivalents, consisting of stock options, determined under the treasury stock method.

Stock Compensation

The Company accounts for employee stock options under the provisions APB Opinion No. 25, *"Accounting for Stock Issued to Employees"* ("APB 25") and has adopted the "disclosure only" alternative described in Statement of Financial Accounting Standards No. 123, *"Accounting for the Stock-Based Compensation"* ("SFAS 123"), which requires pro forma disclosure of compensation expense using a fair value based method of accounting for stock-based compensation plans.

Comprehensive Income

Statement of Financial Accounting Standards 130, *"Reporting Comprehensive Income,"* (SFAS 130) establishes standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The objective of SFAS 130 is to report a measure of all changes in equity of an enterprise that result from transactions and other economic events of the period other than transactions with stockholders ("comprehensive income"). Comprehensive income is the total of the net income (loss) and all other non-owner changes in equity. For the year ended December 31, 1999, 1998 and 1997, the Company's comprehensive earnings (loss) was equal to net earnings (loss).

Recently Issued Accounting Pronouncement

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. The statement requires companies to recognize all derivatives as either assets or liabilities, with the instruments measured at fair value. The accounting for changes in fair value, gains or losses, depends on the intended use of the derivative and its resulting designation. In June, 1999, the Financial Accounting Standards Board issued SFAS 137, "Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of FASB No. 133 — An amendment of FASB Statement No. 133." SFAS 137 defers the effective date of SFAS 133 to all fiscal quarters of all fiscal years beginning after June 15, 2000. The Company does not expect the adoption of SFAS 133 to have a material impact on its financial position or results of operations.

Reclassification

Certain amounts in the 1998 and 1997 financial statements have been reclassified to conform to the 1999 presentation.

(2) Balance Sheet Components

Accounts receivable consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Accounts receivable, net:		
Trade accounts receivable	$ 11,797	$ 10,963
Direct call provisioning receivable	7,268	6,190
Customer reimbursable receivable	1,161	785
Other receivables	231	547
	20,457	18,485
Less: Allowance for doubtful accounts	(3,589)	(1,996)
	$ 16,868	$ 16,489

Bad debt expense was $4,981,000, $4,930,000, and $3,785,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

Property and equipment consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Property and equipment, net:		
Telecommunications equipment	$ 55,487	$ 52,075
Construction in progress	7,341	5,011
Office equipment	9,169	7,326
	71,997	64,412
Less: Accumulated depreciation and amortization	(38,139)	(32,914)
	$ 33,858	$ 31,498

Intangible and other assets consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Intangible and other assets, net:		
Patent license rights	$ 3,325	$ 3,325
Purchased technology assets	2,487	—
Capitalized software development costs	651	1,821
Acquired software technologies	1,783	1,726
Patent defense and application costs	2,583	2,523
Deposits and long-term prepayments	1,183	503
Other	1,649	1,793
	13,661	11,695
Less: Accumulated amortization	(4,409)	(2,959)
	$ 9,252	$ 8,736

(2) Balance Sheet Components — (continued)

Accrued liabilities consist of the following:

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Accrued liabilities:		
Deferred revenue and customer advances	$ 2,114	$ 1,228
Compensation related	1,175	1,292
Other	4,317	3,157
	$ 7,606	$ 5,677

(3) Mergers and Acquisitions

Gateway

On June 14, 1999, the Company completed a merger with Gateway, by exchanging 3,672,234 shares of its common stock for all of the common stock of Gateway. Each share of Gateway was exchanged for 5.0375 shares of T-NETIX common stock. Outstanding Gateway stock options were also converted at the same exchange factor into options to purchase approximately 379,000 shares of T-NETIX common stock.

In addition, in connection with the merger transaction, T-NETIX issued 375,341 shares of common stock to certain shareholders of Gateway in exchange for terminating a royalty agreement. The royalty agreement related to automated call processing technology and intellectual property rights that were assigned to Gateway by the royalty owners in exchange for royalty payments. The termination of the royalty owners' interests resulted in the acquisition of an intangible asset. The asset has been recorded at fair value, or $2,487,000. The fair value is based on the value of T-NETIX common stock at February 10, 1999 (date of the Merger Agreement), or $6.625, times the number of shares issued in exchange for termination of the royalty owners' interests. The intangible asset has been recorded in patent license rights and has an estimated useful life of 10 years, the remaining term of the underlying patent.

Selected financial data of T-NETIX and Gateway, prior to the merger were as follows:

	Three Months Ended March 31, 1999	Years Ended December 31, 1998	Years Ended December 31, 1997
	(amounts in thousands)		
Revenue:			
T-NETIX	$ 8,669	$ 38,008	$ 36,292
Gateway	9,115	30,233	26,013
Combined	$ 17,784	$ 68,241	$ 62,305
Net earnings (loss):			
T-NETIX	$ (1,077)	$ 394	$ 591
Gateway	245	(124)	1,154
Combined	$ (832)	$ 270	$ 1,745

Transactions between T-NETIX and Gateway prior to the merger consisted of revenue from a cross-licensing agreement. All such amounts have been eliminated in the restated consolidated financial statements. There were no material adjustments required to conform the accounting policies of the two companies.

(3) Mergers and Acquisitions — (continued)

Certain reclassifications were made to the Gateway financial statements to conform to T-NETIX's presentations.

In connection with the merger, the Company incurred merger transaction expenses of $1,017,000 for the year ended December 31, 1999. Merger transaction expenses consisted primarily of fees for investment bankers, attorneys, accountants, financial printing and other related charges.

Evans and Ricker Acquisition

Effective October 28, 1999, the Company completed the acquisition of substantially all of the assets of Evans and Ricker ("E&R"), of Portland, Oregon. E&R specialize in software used to control and manage information for correctional facilities. E&R's product, Lock and Track Corrections Information System ("Lock & Track™") is a comprehensive relational database designed to handle the operational control and reporting needs of municipal, state, federal, and/or private correctional facilities. The purchase price was approximately $1.4 million including acquisition costs. The acquisition has been accounted for using the purchase method of accounting. The results of operations associated with the assets acquired are included in the Company's financial statements beginning November 1, 1999. Assets acquired and liabilities assumed have been recorded at their fair values. The assets acquired were cash, accounts receivable and intangibles. The estimated excess of cost over the estimated fair value of the net assets acquired of approximately $1.3 million was allocated principally to goodwill, which will be amortized on a straight line basis over 7 years. The remaining net assets acquired were primarily current assets (cash and accounts receivable) net of current liabilities (accounts payable and accrued liabilities). The acquisition was funded by borrowings under the Company's line of credit. Pro forma information giving effect to this acquisition has been omitted as the pro forma results do not vary materially from the Company's recorded results, as E&R's operations were not significant in 1998 or 1997.

(4) SpeakEZ Operations

In December 1998, the Company began an evaluation of the SpeakEZ Division and determined that the best course of action was to combine its research and development operations previously located in New Jersey with its corporate operations in Englewood, Colorado. This change coincided with the resignation of the Company's former chief executive officer on December 9, 1998. This individual spent a majority of his time in the SpeakEZ Division. For the five months ended December 31, 1998, the Company charged the cost of the severance agreement or approximately $240,000 to SpeakEZ selling, general and administrative expense.

The Company completed the reorganization of SpeakEZ operations in February 1999. The reorganization also included a change in the marketing strategy from a direct customer sales strategy to a technology licensing strategy. A direct customer sales strategy markets a specifically developed software product to a specific, end user customer. The strategy is then to find other specific customers who have similar operating systems and market this product to them. In contrast, a technology licensing strategy focuses on a larger scale customer who can integrate the SpeakEZ software product into its existing product line. This larger customer, such as a computer manufacturer, is then responsible for the product integration and ultimate delivery to the end user customer.

The change in marketing approach noted above required the Company to evaluate future marketability of all products in the SpeakEZ Division. As a result of this evaluation, management determined that the capitalized cost for SpeakEZ products, some of which would no longer be marketed, exceeded their estimated realizable value. For the five months ended December 31, 1998, the Company incurred a charge of $490,000 for a reduction in the carrying value of such capitalized costs to their estimated net realizable value.

(4) SpeakEZ Operations (continued)

The Company also recognized a loss in the SpeakEZ Division on a note receivable made to a venture partner for $300,000. In December 1998, the venture partner notified the Company that its plans to raise capital prior to January 1999 were not progressing according to plan and as a result it would not be able to meet its obligations as they became due.

(5) Debt

Debt at December 31, 1999 and 1998 is summarized as follows:

	December 31,	
	1999	1998
	(amounts in thousands)	
Debt:		
Bank lines of credit	$ 28,461	$ 16,972
Advances on direct call processing	—	2,531
Notes payable to stockholders	—	4,800
Notes payable to banks	—	625
Other	460	582
	28,921	25,510
Less current portion	7,366	21,353
Non current portion	$ 21,555	$ 4,157

In September 1999, the Company entered into a Senior Secured Revolving Credit Facility (the "Credit Facility") with its commercial bank. The Credit Facility provides for maximum credit of $40,000,000 subject to limitations based on financial covenant calculations. The Credit Facility is comprised of a one year LIBOR component of $15,000,000 at an interest rate of LIBOR plus 2.75% at December 31, 1999; a three month LIBOR component of $10,000,000 at an interest rate of LIBOR plus 2.75% at December 31, 1999; and $3,461,000 at the Bank's prime rate, 8.5% at December 31, 1999. As of December 31, 1999, the interest rate on borrowings under the line of credit ranged from 8.50% to 8.87%. The Company also pays a fee of 0.30% per annum on the unused portion of the line of credit.

The Credit Facility is collateralized by substantially all of the assets of the Company. Under the terms of the Credit Facility, the Company is required to maintain certain financial ratios and other financial covenants. These ratios include a debt to a four quarter rolling earnings before interest, taxes and depreciation and amortization (EBITDA) ratio, a ratio of fixed charges (interest and debt payments) to EBITDA, and minimum quarterly EBITDA. The Agreement also prohibits the Company from incurring additional indebtedness.

At December 31, 1999 the Company was in violation of certain covenants and the Company has received a waiver from its lenders relating to various covenant violations. In connection with the waiver, the lenders agreed to revise the existing covenant requirements if the Company can raise $7 million of additional financing on or before April 14, 2000. The funds raised are required to be used to reduce the outstanding balance on the Credit Facility. The terms of the bank dictate that $7 million of the Credit Facility is due April 14, 2000 with the remaining balance of the facility due April 30, 2001. The amount of credit under the Credit facility available to the Company is dependent upon our financial performance and may be less than $40 million.

(6) Stockholders' Equity

Stock Option Plans

The Company has reserved 3,850,000 shares of common stock for employees and non-employee directors under various stock option plans (collectively the "Plans"): the 1991 Incentive Stock Option Plan ("the 1991 ISO Plan"); the 1991 Non-Qualified Stock Option Plan ("the 1991 NSO Plan"); and the 1993 Incentive Stock Option Plan ("the 1993 ISO Plan"). The Plans provide for issuing both incentive stock options, and non-qualified stock options, which must be granted at not less than 100% of the fair market value of the stock on the date of grant. All options to date have been granted at the fair market value of the stock as determined by the Board of Directors. Options issued prior to 1994 had vesting terms of one to three years from the date of grant. Substantially all of the Incentive Stock Options issued after 1993 vest over four years from the date of grant. The options expire ten years from the date of grant.

A summary of the Company's stock option activity, and related information through December 31, 1999 is as follows:

		Options Outstanding	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price
Balance at January 1, 1997	476,163	2,513,957	$ 4.55
Granted	(111,500)	111,500	$ 8.61
Exercised	—	(281,200)	$ 2.67
Canceled	96,875	(96,875)	$ 6.83
Balance at December 31, 1997	461,538	2,247,382	$ 4.98
Granted	(246,619)	246,619	$ 5.24
Exercised	—	(77,477)	$ 2.38
Canceled	166,000	(166,000)	$ 6.45
Balance at December 31, 1998	380,919	2,250,524	$ 4.88
Granted	(223,800)	223,800	$ 5.14
Exercised	—	(93,425)	$ 2.61
Canceled	456,769	(456,769)	$ 6.92
Balance at December 31, 1999	613,888	1,919,130	$ 4.56

The range of exercise prices for common stock options outstanding and options exercisable at December 31, 1999 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 0.20	281,475	1.3 years	$ 0.20	281,475	$ 0.20
$ 1.61	307,490	6.7 years	$ 1.61	307,490	$ 1.61
$ 3.00-$4.11	154,090	4.4 years	$ 3.32	136,590	$ 3.25
$ 4.12-$5.48	222,800	9.2 years	$ 5.08	30,000	$ 3.64
$ 5.49-$7.24	455,525	6.2 years	$ 5.58	169,025	$ 5.30
$ 7.25	394,750	6.1 years	$ 7.25	359,875	$ 7.25
$ 7.26-$10.99	53,000	7.9 years	$ 9.07	36,750	$ 9.12
$11.00-$13.71	50,000	6.0 years	$13.44	46,250	$13.64
$ 0.20-$13.71	1,919,130	5.8 years	$ 4.56	1,367,455	$ 4.31

(6) Stockholders' Equity (continued)

The Company has not recorded compensation expense for stock options granted. The Company has computed the pro forma disclosures required under SFAS 123 for stock options granted using the Black-Scholes option-pricing model. The assumptions are as follows:

	Year Ended December 31,		
	1999	1998	1997
Risk free interest rate	5.43%	5.24%	5.24%
Expected dividend yield	—	—	—
Expected lives (in years)	5.2 years	5.0 years	4.9 years
Expected volatility	70.0%	70.0%	70.0%
Weighted average remaining contractual life of options outstanding	5.8 years	4.9 years	5.2 years
Weighted average fair value at grant date	$3.24	$2.35	$4.11

The pro forma effects of applying SFAS 123 are as follows for the years ended December 31, 1999, 1998, and 1997:

	Year Ended December 31,		
	1999	1998	1997
	(amount in thousands)		
Net earnings (loss):			
As reported	$(10,247)	$ 270	$1,745
Pro forma	(11,118)	(847)	620
Net earnings (loss) per common share:			
As reported:			
Basic	$ (0.82)	$ 0.02	$ 0.15
Diluted	(0.82)	0.02	0.13
Pro forma:			
Basic	$ (0.89)	$(0.07)	$ 0.05
Diluted	(0.89)	(0.07)	0.05

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models to not necessarily provide a reliable single measure of the fair value of its employee stock options.

In July, 1997, the Board of Directors amended the 1993 ISO Plan and the 1991 NSO Plan to provide that the Compensation Committee may amend certain outstanding options with an exercise price in excess of the current market price in order to modify the exercise price to the current market price or greater. On August 11, 1997, the Compensation Committee re-priced the exercise price to $7.25 per share for certain outstanding options under the 1993 ISO Plan and the 1991 NSO Plan having an exercise price equal to or greater than $7.50 prior to such re-pricing. This re-pricing affected 773,500 options granted under these Plans.

(7) Segment Information

Statement of Financial Accounting Standards No. 131, Disclosures About Segments of an Enterprise and Related Information, ("SFAS 131") establishes standards for the way public enterprises report information about operating segments in annual financial statements. SFAS 131 also establishes standards for disclosures about products and services, geographic areas and major customers.

The Company has three reportable segments; the Corrections Divisions, the SpeakEZ Division, and Internet Services Division. The Company evaluates performance based on earnings (loss) before income taxes. Additional measures include operating income, depreciation and amortization, and interest expense. There are no intersegment sales. The Company's reportable segments are specific business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Segment information is as follows:

	Years Ended December 31,		
	1999	1998	1997
	(amounts in thousands)		
Revenue from external customers:			
Corrections Division	$ 71,596	$ 67,609	$ 61,629
SpeakEZ Division	93	632	676
Internet Services Division	1,546	—	—
Operating income (loss):			
Corrections Division	$ (5,796)	$ 6,816	$ 7,031
SpeakEZ Division	(2,518)	(3,996)	(2,664)
Internet Services Division	104	—	—
Depreciation and amortization			
Corrections Division	$ 10,651	$ 9,250	$ 8,841
SpeakEZ Division	969	924	705
Internet Services Division	—	—	—
Interest and other income (expense)			
Corrections Division	$ (1,217)	$ (1,762)	$ (1,216)
SpeakEZ Division	(920)	(592)	(367)
Internet Services Division	—	—	—
Segment earnings (loss) before tax:			
Corrections Division	$ (8,029)	$ 5,054	$ 5,815
SpeakEZ Division	(3,439)	(4,588)	(3,031)
Internet Services Division	104	—	—
Segment earnings (loss) before tax:			
Revenue from external customers	$ 73,235	$ 68,241	$ 62,305
Operating income (loss)	(8,210)	2,820	4,367
Depreciation and amortization	11,620	10,174	9,546
Interest and other (income) expense, net	2,137	2,354	1,583
Segment earnings (loss) before tax	(11,364)	466	2,784

(7) Segment Information — (continued)

	December 31, 1999	December 31, 1998
	(amounts in thousands)	
Segment assets:		
Corrections Division	$ 66,943	$ 60,840
SpeakEZ Division	3,599	4,599
Internet Services Division	—	—

Substantially all of the Company's reportable segment revenue is derived within the United States. Revenue as a percentage of total revenue attributable to significant customers for the years ended December 31, 1999, 1998 and 1997 is as follows:

	1999	1998	1997
AT&T	13%	16%	19%
Bell Atlantic	10	12	12
SBC Communications	10	12	13

There was no intersegment revenue for the years ended December 31, 1999, 1998 and 1997. Unallocated amounts to arrive at net earnings (loss) included income tax expense (benefit) of $(1,117,000), $196,000, and $1,039,000 for the years ended December 31, 1999, 1998 and 1997, respectively. Consolidated total assets included eliminations of approximately $12,976,000 and $11,084,000 as of December 31, 1999 and 1998, respectively. Eliminations consist of intercompany receivables in the Corrections Division and intercompany payables in the SpeakEZ Division related solely to intercompany borrowing of the SpeakEZ Division.

(8) Income Taxes

Income tax expense for the years ended December 31, 1999, 1998 and 1997 is as follows (amounts in thousands):

	1999	1998	1997
Current:			
Federal	$ (1,007)	$ 186	$ 439
State	(191)	25	30
Total	(1,198)	211	469
Deferred:			
Federal	72	(55)	516
State	9	40	54
Total	81	(15)	570
Total income tax expense (benefit)	$ (1,117)	$ 196	$ 1,039

(8) Income Taxes (continued)

Income taxes differ from the expected statutory income tax benefit, by applying the US federal income tax rate of 34% to pretax earnings for the years ended December 31, 1999, 1998 and 1997 due to the following:

	1999	1998	1997
Expected statutory income tax (benefit) expense	$ (3,864)	$ 273	$ 947
Amounts not deductible for income tax	699	107	97
State taxes, net of federal benefit	(377)	43	55
Change in valuation allowance	2,263	(113)	—
Other	162	(114)	(60)
Total income tax expense (benefit)	$ (1,117)	$ 196	$ 1,039

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities as of December 31, 1999 and 1998 are presented below:

	1999	1998
	(amounts in thousands)	
Deferred income tax assets:		
Net operating loss carryforwards	$ 6,556	$ 5,406
Allowance for doubtful accounts	1,488	716
Other	680	458
Total gross deferred income tax assets	8,724	6,580
Less valuation allowance	(3,727)	(1,464)
	4,997	5,116
Deferred income tax liabilities:		
Intangible assets, due to difference in book/tax basis	(474)	(1,068)
Property and equipment, principally due to differences in depreciation	(1,867)	(2,523)
Other assets, due to differences in book/tax basis	(359)	(563)
Total gross deferred tax liabilities	(2,700)	(4,154)
	$ 2,297	$ 962

At December 31, 1999, the Company had net operating loss carryforwards for tax purposes aggregating approximately $17.4 million which, if not utilized to reduce taxable income in future periods, expire at various dates through the year 2010. Approximately $1.3 million of the net operating loss carryforwards are subject to certain rules limiting their annual usage. The Company believes these annual limitations will not ultimately affect the Company's ability to use substantially all of its net operating loss carryforwards for income tax purposes.

A valuation allowance is provided when it is more likely than not that some portion or the entire net deferred tax asset will not be realized. The Company has offset a portion of its deferred tax assets with a valuation allowance. The valuation allowance will be adjusted in the future based on the Company's projected taxable income.

The exercise of stock options, which have been granted under the Company's 1991 NSO stock option plan gives rise to compensation which is included in the taxable income of the applicable option holder and is deductible by the Company for federal and state income tax purposes. The income tax benefit associated with the exercise of the NSO options is recorded as an adjustment to additional paid-in capital when realized.

(9) Commitments and contingencies

The Company leases office space under operating lease agreements. Rent expense under operating lease agreements for the years ended December 31, 1999, 1998 and 1997 was approximately $1,034,000, $930,000, and $629,000, respectively. Future minimum lease payments under these lease agreements for each of the next five years are summarized as follows (amounts in thousands):

Year ending December 31:	
2000	$ 976
2001	721
2002	229
2003	5
Total minimum lease payments	$1,931

The Company is involved in various legal proceedings of a nature considered normal to its business. It is the Company's policy to accrue amounts related to these legal matters if it is probable that a liability has been incurred an amount that is reasonable estimable. In the opinion of management, all matters are of such a nature as would not have a material affect on the Company's financial position, results of operations and cash flows of the Company if resolved unfavorably.

INDEPENDENT AUDITORS' REPORT ON SCHEDULE

The Board of Directors and Shareholders
T-NETIX, Inc.:

Under the date of March 21, 2000, we reported on the consolidated balance sheets of T-NETIX, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1999. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement Schedule II. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

Denver, Colorado
March 21, 2000

SCHEDULE II

T-NETIX, INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS

Years Ended December 31, 1999, 1998 and 1997

(Amounts in Thousands)

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions/ Write-offs	Balance at End of Period
Year Ended December 31, 1997:				
Allowance for doubtful accounts	$ 989	$3,785	$(3,821)	$ 953
Year Ended December 31, 1998:				
Allowance for doubtful accounts	$ 953	$4,930	$(3,887)	$1,996
Year Ended December 31, 1999:				
Allowance for doubtful accounts	$1,996	$4,981	$(3,388)	$3,589

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarter Ended September 30, 2000

Commission File Number 0-25016

T-NETIX, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Colorado (State of Other Jurisdiction of Incorporation)	**84-1037352** (I.R.S. Employer Identification No.)
67 Inverness Drive East **Englewood, Colorado** (Address of principal executive offices)	**80112** (Zip Code)

Registrant's Telephone Number, Including Area Code: **(303) 790-9111**

Indicate by check ☑ whether the registrant (1) has filed all reports required to filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Class	Outstanding at November 9, 2000
Common Stock, $.01 stated value	12,978,242

FORM 10-Q CROSS REFERENCE INDEX

PART I

Item 1. *Financial Statements*

INDEX TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

T-NETIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2000	December 31, 1999
	(Amounts in Thousands)	
ASSETS		
Cash and cash equivalents	$ 14	$ 118
Accounts receivable, net	18,583	16,459
Prepaid expenses	1,936	1,038
Inventories	192	710
Total current assets	20,725	18,325
Property and equipment, net	36,552	33,858
Goodwill, net	5,860	6,401
Deferred tax asset	2,247	2,297
Intangible and other assets, net	8,460	9,252
Total assets	$ 73,844	$ 70,133
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$ 10,597	$ 13,187
Accrued liabilities	6,072	5,924
Current portion of long term debt	32,209	7,366
Total current liabilities	48,878	26,477
Long-term debt	43	21,555
Total liabilities	48,921	48,032
Series A redeemable convertible preferred stock, $1,000 per share, stated value, 3,750 shares authorized; issued and outstanding at September 30, 2000; liquidation preference of $3,875,000 at September 30, 2000	2,357	—
Stockholders' equity:		
Common stock, $.01 stated value, 70,000,000 shares authorized; 12,733,084 and 12,699,400 shares issued and outstanding at September 30, 2000 and December 31, 1999, respectively	127	127
Additional paid-in capital	37,052	35,791
Accumulated deficit	(14,613)	(13,817)
Total stockholders' equity	22,566	22,101
Commitments and contingencies		
Total liabilities, redeemable convertible preferred stock and stockholders' equity	$ 73,844	$ 70,133

See accompanying notes to condensed consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
	(Amounts in Thousands, Except Per Share Amounts)			
Revenue:				
Telecommunications services	$14,615	$ 9,761	$36,693	$ 29,631
Direct call provisioning	6,811	6,811	21,303	20,334
Internet services	7,367	—	19,928	—
Equipment sales and other	494	190	1,701	2,318
Total revenue	29,287	16,762	79,625	52,283
Expenses:				
Operating costs:				
Telecommunications services	5,405	4,509	15,265	13,177
Direct call provisioning	6,050	6,281	19,318	18,820
Internet services	5,953	—	16,602	—
Cost of equipment sold and other	105	56	655	934
Total operating costs	17,513	10,846	51,840	32,931
Selling, general and administrative	5,144	3,440	13,464	9,907
Research and development	1,236	1,100	3,980	3,716
Impairment of telecommunication assets	—	4,632	—	4,632
Depreciation and amortization	3,106	2,947	9,273	8,618
Total expenses	26,999	22,965	78,557	59,804
Operating income (loss)	2,288	(6,203)	1,068	(7,521)
Merger transaction expenses	—	—	—	(1,017)
Interest and other expense, net	(734)	(479)	(1,760)	(1,595)
Income (loss) before income taxes	1,554	(6,682)	(692)	(10,133)
Income tax (expense) benefit	—	—	(103)	1,117
Net income (loss)	1,554	(6,682)	(795)	(9,016)
Accretion of discount on redeemable convertible preferred stock	(515)	—	(945)	—
Net income (loss) applicable to common stockholders	$ 1,039	$(6,682)	$(1,740)	$ (9,016)
Basic net income (loss) per common share	$ 0.08	$ (0.53)	$ (0.14)	$ (0.72)
Diluted net income (loss) per common share	$ 0.08	$ (0.53)	$ (0.14)	$ (0.72)
Shares used in computing basic net income (loss) per common share	12,733	12,699	12,761	12,448
Shares used in computing diluted net income (loss) per common share	13,025	12,699	12,761	12,448

See accompanying notes to condensed consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
	(Amounts in Thousands)	
Cash flows from operating activities:		
Net loss	$ (795)	$ (9,016)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	9,273	8,618
Impairment loss	—	4,632
Deferred income tax expense (benefit)	50	(1,338)
Gain on sale of property and equipment	(324)	(108)
Accretion of discount on subordinated note payable	40	—
Changes in operating assets and liabilities:		
Accounts receivable, net	(2,124)	1,253
Prepaid expenses	(898)	(512)
Inventories	518	—
Intangibles and other assets	(410)	(186)
Accounts payable	(2,590)	4,349
Accrued liabilities	142	68
Cash provided by operating activities	2,882	7,760
Cash used in investing activities:		
Purchase of property and equipment	(10,178)	(10,080)
Proceeds from disposal of property and equipment	350	—
Other investing activities	(23)	(803)
Cash used in investing activities	(9,851)	(10,883)
Cash flows from financing activities:		
Net proceeds from (payments on) line of credit	(69)	5,877
Proceeds from debt	3,750	25,000
Payments of debt	(350)	(27,790)
Proceeds from issuance of redeemable convertible preferred stock, net	3,459	—
Common stock issued for cash under stock option plans	75	257
Cash provided by financing activities	6,865	3,344
Net increase (decrease) in cash and cash equivalents	(104)	221
Cash and cash equivalents at beginning of period	118	678
Cash and cash equivalents at end of period	$ 14	$ 899
Cash paid for interest	$ 1,535	$ 1,639
Cash paid for income taxes	$ 103	$ 113

See accompanying notes to condensed consolidated financial statements.

T-NETIX, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Summary of Significant Accounting Policies

Unaudited Financial Statements

The accompanying unaudited consolidated financial statements reflect all adjustments which, in the opinion of management, are necessary to reflect a fair presentation of the financial position and results of operations of T-NETIX, Inc. and subsidiaries (the Company) for the interim periods presented. All adjustments, in the opinion of management, are of a normal and recurring nature. Some adjustments involve estimates, which may require revision in subsequent interim periods or at year-end. The financial statements have been presented in accordance with generally accepted accounting principles. Refer to notes to consolidated financial statements, which appear in the 1999 Annual Report on Form 10-K for the Company's accounting policies, which are pertinent to these statements.

Basis of Presentation

On June 14, 1999, the Company completed a merger with Gateway Technologies, Inc. ("Gateway"), a privately held provider of inmate calling services. As a result of the merger, Gateway became a wholly owned subsidiary of the Company. Prior to the merger, the Company changed its year-end from July 31 to December 31. Gateway's year-end was December 31.

The merger was accounted for as a pooling of interests. As a result, the Company's financial statements have been restated to combine Gateway's financial statements as if the merger had occurred at the beginning of the earliest period presented. Information concerning common stock and per share data has been restated on an equivalent share basis.

Liquidity

The Company recorded net income from operations of $1.6 million in the three months and a net loss of $795,000 for the nine months ended September 30, 2000. The working capital deficit as of September 30, 2000 was $28.1 million. In July 2000, the Company and its lenders amended the Company's credit agreement to revise certain financial covenants and extended the maturity date until April 30, 2001, and as a result the debt with the bank has been classified as a current liability.

The Company has taken steps to increase cash flow from operations, including renegotiating contract pricing and cost control measures, in order to carry out the remainder of its fiscal 2000 business plan. These changes have allowed the company to generate net income for the three months ended September 30, 2000. A decrease in cash flows from operations for the nine months ended September 30, 2000 was primarily the result of higher levels of trade receivables and a reduction in trade payables. The Company will require additional financing to fund operations and to repay or refinance existing debt as it becomes due. If the Company is not able to obtain financing on terms acceptable to the Company it may have to curtail its operations.

Earnings (Loss) Per Common Share

Earnings (loss) per common share is presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, *Earnings Per Share* (SFAS 128). Basic earnings per share excludes the impact of potentially dilutive securities and is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the three months ended September 30, 2000 diluted common and common equivalent shares outstanding includes 292,000 of common share equivalents, consisting of stock options and warrants and redeemable convertible preferred stock, determined under the treasury stock method. There is no difference between basic and diluted net loss per share since

(1) Summary of Significant Accounting Policies — (Continued)

potentially dilutive securities from the conversion of redeemable convertible preferred stock and the exercises of options and warrants are anti-dilutive for the nine months ended September 30, 2000 and the three and nine months ended September 30, 1999. The calculations of diluted net loss per common share for the nine months ended September 30, 2000 and the three and nine months ended September 30, 1999, do not include 359,000, 355,000 and 400,000, respectively, of potentially dilutive securities, including common stock options and warrants and redeemable convertible preferred stock.

Recent Accounting Pronouncements

In March 2000, the Financial Accounting Standards Board ("FASB") issued interpretation No. 44 "Accounting for Certain Transactions involving Stock Compensation — an interpretation of APB Opinion No. 25 ("FIN 44"). This interpretation provides guidance on the accounting for certain stock option transactions and subsequent amendments to stock option transactions. FIN 44 is effective July 1, 2000, but certain provisions cover specific events that occur after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 did not have a material effect on the financial position or results of operations of the company.

In December 1999, the SEC released Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," which provides guidance on the recognition, presentation, and disclosure of revenue in financial statements filed with the SEC. Subsequently, the SEC delayed the implementation date of SAB 101 for the Company until the quarter ended December 31, 2000. The Company does not expect the adoption of SAB 101 to have a material impact on its financial position or results of operations.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137. SFAS 137 defers the effective date of SFAS 133 to all fiscal quarters of all fiscal years beginning after June 15, 2000. SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. SFAS 133 requires companies to recognize all derivatives as either assets or liabilities, with the instruments measured at fair value. The accounting for changes in fair value, gains or losses, depends on the intended use of the derivative and its resulting designation. The Company does not expect the adoption of SFAS 133 to have a material impact on its financial position or results of operations.

Reclassification

Certain amounts in the 1999 financial statements have been reclassified to conform to the 2000 presentation.

(2) Balance Sheet Components

Accounts receivable consist of the following:

	September 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Accounts receivable, net:		
Trade accounts receivable	$14,353	$12,549
Direct call provisioning receivable	5,168	7,268
Other receivables	445	231
	19,966	20,048
Less: Allowance for doubtful accounts	(1,383)	(3,589)
	$18,583	$16,459

Bad debt expense was $1.3 million and $1.4 million for the three months ended September 30, 2000 and 1999, respectively, and $3.9 million and $4.3 million for the nine months ended September 30, 2000 and 1999, respectively.

Property and equipment consists of the following:

	September 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Property and equipment, net:		
Telecommunications equipment	$ 61,754	$ 55,487
Construction in progress	6,702	7,341
Office equipment	11,733	9,169
	80,189	71,997
Less: Accumulated depreciation and amortization	(43,637)	(38,139)
	$ 36,552	$ 33,858

Intangible and other assets consist of the following:

	September 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Intangible and other assets, net:		
Patent license rights	$ 3,325	$ 3,325
Purchased technology assets	2,487	2,487
Capitalized software development costs	663	651
Acquired software technologies	1,961	1,783
Patent defense and application costs	2,590	2,583
Deposits and long-term prepayments	1,724	1,183
Other	1,270	1,649
	14,020	13,661
Less: Accumulated amortization	(5,560)	(4,409)
	$ 8,460	$ 9,252

(2) Balance Sheet Components — (Continued)

Accrued liabilities consist of the following:

	September 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Accrued liabilities:		
Deferred revenue and customer advances	$1,653	$2,114
Compensation related	1,402	1,175
Other	3,017	2,635
	$6,072	$5,924

(3) Debt

Debt consists of the following:

	September 30, 2000	December 31, 1999
	(Amounts in Thousands)	
Debt:		
Bank lines of credit	$28,392	$28,461
Subordinated note payable	3,750	—
Other	110	460
	32,252	28,921
Less current portion	32,209	7,366
Non current portion	$ 43	$21,555

Bank Line of Credit

In September 1999, the Company entered into a Senior Secured Revolving Credit Facility (the "Credit Facility") with its commercial bank. The Credit Facility provides for maximum credit of $40 million subject to limitations based on financial covenant calculations. The Credit Facility is comprised of a one month LIBOR component of $23.5 million at an interest rate of LIBOR plus 2.75% at September 30, 2000; and $4.9 million at the Bank's prime rate, 9.5% at September 30, plus 0.5%. As of September 30, 2000, the interest rates on borrowings under the bank Credit Facility ranged from 9.4% to 10.0%. The Company also pays a fee of 0.3% per annum on the unused portion of the line of credit.

The Credit Facility is collateralized by substantially all of the assets of the Company. Under the terms of the Credit Facility, the Company is required to maintain certain financial ratios and other financial covenants. These ratios include a debt to a four quarter rolling earnings before interest, taxes and depreciation and amortization (EBITDA) ratio, a ratio of fixed charges (interest and debt payments) to EBITDA, and minimum quarterly EBITDA. The agreement also prohibits the Company from incurring additional indebtedness.

In July 2000, the Company and its lenders amended its credit agreement to provide for revised financial covenants and extended the maturity date until April 30, 2001 and as a result the debt with the bank has been classified as a current liability. The Company raised $7.5 million of additional financing in April 2000. The net proceeds were used to reduce the outstanding balance on the credit facility. As of September 30, 2000, the Company is in compliance with all terms of the amended agreement with the lenders. The maximum amount of credit under the credit facility available to the Company is dependent upon the Company's financial performance. Based on the financial covenants, the Company's maximum available borrowings at September 30, 2000 were $34.3 million.

(3) Debt — (Continued)

Subordinated Note Payable

The Company issued a subordinated note payable of $3.75 million, due April 30, 2001, to a director an significant shareholder of the Company. The note bears interest at prime rate plus one percent per annu (10.5% at September 30, 2000) which is payable every six months beginning in October 2000. The lender al received warrants to purchase 25,000 shares of common stock at an exercise price of $6.05 per share for period of five years. The estimated fair value of the stock purchase warrants, calculated using the Blac Scholes model, has been recorded as deferred financing fees and is being amortized over the term of the deb

(4) Stockholders Equity

In April 2000, the company issued 3,750 shares of series A non-voting redeemable convertible prefer stock and five-year stock purchase warrants to acquire 340,909 common shares for net proceeds $3.5 million. The company accounted for the transaction in accordance with ETIF 98-5, "Accounting f Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios The Company recognized an increase in additional paid in capital in the amount of $771,000 for the value the beneficial conversion. The Company is accreting the resulting discount on the preferred stock to incom (loss) applicable to common stockholders over the six-month period beginning April 17, 2000. The series preferred stock does not bear any dividends.

In the event of any liquidation, dissolution or winding up of the Company, merger with a change in voti control or a sale of substantially all of the Company's assets, the holders of the redeemable convertib preferred stock are entitled to receive a liquidation preference of 8% per annum. If the funds available distribution are insufficient to cover the liquidation preference, then the entire assets and funds of t Company legally available for distribution are to be distributed ratably among the holders of the redeemab convertible preferred stock.

The preferred stock is convertible by the holder beginning on October 17, 2000. The redeemab convertible preferred stock is convertible into a number of common shares calculated by dividing (I) the su of (a) the stated value of the preferred stock plus (b) a premium amount which is the product of the stat value multiplied by 8% annualized for the period outstanding, by the Conversion Price. The number of sha issuable upon any conversion plus any other shares held by the holders cannot exceed 4.9% of the outstandi shares of the Company's common stock.

The Conversion Price is the lesser of the Variable Conversion Price and the Fixed Conversion Price. T Variable Conversion Price is defined as the average closing bid prices for any five consecutive trading da during the twenty-two consecutive trading day period ending one trading day prior to a notice of conversi The Fixed Conversion Price was initially set at $6.05. In accordance with the original agreement, the Fix Conversion Price was re-set to $4.1388 as of August 17, 2000.

The preferred stock is redeemable at the option of the Company if the closing market price of t Company's common stock is less than or equal to $4.00 for 10 consecutive days. The optional redemption available to the Company as long as (i) all of the shares of common stock issuable upon conversion of t Series A preferred stock are then authorized and reserved for issuance, registered for sale under the 1933 A by the Company and such shares are eligible to trade on Nasdaq and (ii) no Mandatory Redemption Event Trading Market Redemption event has occurred and is continuing. The amount of cash payable upon optional redemption is the greater of (i) 120% of the liquidation preference or (ii) a parity value. The par value is the product of (a) the number of shares of common stock issuable upon conversion of the redeema preferred stock, as calculated using the conversion price noted above, multiplied by (b) the highest clos price of the common stock during the period from the date the notice of redemption was delivered and end one day prior to the redemption date.

(4) Stockholders Equity — (Continued)

If the Company provides notice at the beginning of a month in which conversion is requested, it will have the option to redeem any preferred shares submitted for conversion by the holders in cash rather than by issuing shares of common stock. The price used in the redemption shall be the closing price of the common stock on the date of conversion. The conversion date is set by the holder upon the notice of conversion. Any amounts due in cash to the holders must be paid within two trading days of the conversion.

In the event the Company publicly announces its intention to consummate a major transaction, such as the sale, conveyance or disposition of all or substantially all of the assets of the Company, the effectuation by the Company of a transaction or series of transactions in which more than 50% of the voting power of the Company is disposed of, or the consolidation, merger or other business combination of the Corporation when the Company is not the survivor, at the option of the holders of preferred shares, (A) the company shall be required to distribute 120% of the calculated liquidation preference to holders of the preferred shares; or (B) if the transaction results in the common stock of the Company being changed into securities or assets of another corporation, the holders of the preferred shares can elect to receive such securities or assets that such holder of the preferred shares would have been entitled to receive had the holder converted the preferred shares in full immediately prior to the transaction. Alternatively, upon the happening of one of these major transaction events, the Company can elect to redeem the preferred shares from the holders rather than distributing the liquidation preference. The major transaction redemption amount will be equal to the greater of (x) the major transaction percentage, which is (A) 165% in the case of a major transaction consummated in the prior to April 17, 2001, (B) 200% in the case of a major transaction consummated on or after April 17, 2001, multiplied by the sum of (a) the stated value of the shares to be redeemed, plus (b) an amount equal to 8% per annum of the stated value for the period outstanding, plus (c) any conversion default payments, and the equivalent value of the shares to be redeemed. The equivalent value means the product of (a) the number of shares of common stock issuable upon conversion of the preferred stock utilizing the dates of the major transaction as the trading days, and the conversion price calculations noted above, multiplied by (b) the price per share of common stock paid to the stockholders in connection with the major transaction.

In connection with the issuance of the redeemable convertible preferred stock, the Company issued a five-year stock purchase warrant exercisable for 340,909 shares at $6.60 per share of the Company's common stock. The Company allocated the fair value of the warrants ($1.1 million) to additional paid in capital and recognized a discount on the preferred shares issued. The Company also issued warrants to purchase 50,000 shares of common stock to the broker on the sale of preferred stock at an exercise price of $6.60 per share. The stock purchase warrants were valued at fair value ($163,000) using the Black-Scholes model and are being amortized as accretion of discount on preferred stock over the term of the preferred stock.

(5) Commitments and Contingencies

Future minimum lease payments under operating leases for the next five years total approximately $1.5 million.

(6) Segment Information

The Company has three reportable segments; the Corrections Divisions, the SpeakEZ Division, and the Internet Services Division. The Company evaluates performance based on earnings (loss) before income taxes. Additional measures include operating income, depreciation and amortization, and interest expense. There are no intersegment sales. The Company's reportable segments are specific business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The accounting policies of the reportable segments are the same as those

(6) Segment Information — (Continued)

described in the summary of significant accounting policies. Segment information for the three and s
months ended September 30, 2000 and 1999 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
	(Amounts in Thousands)			
REVENUE FROM EXTERNAL CUSTOMERS:				
Corrections Division	$21,910	$16,733	$59,587	$ 52,198
SpeakEZ Division	10	29	110	85
Internet Services Division	7,367	—	19,928	—
	$29,287	$16,762	$79,625	$ 52,283
OPERATING INCOME (LOSS):				
Corrections Division	$ 1,314	$(5,628)	$ (889)	$ (5,576)
SpeakEZ Division	(440)	(575)	(1,369)	(1,945)
Internet Services Division	1,414	—	3,326	—
	$ 2,288	$(6,203)	$ 1,068	$ (7,521)
DEPRECIATION AND AMORTIZATION:				
Corrections Division	$ 2,901	$ 2,713	$ 8,602	$ 7,886
SpeakEZ Division	205	234	671	732
Internet Services Division	—	—	—	—
	$ 3,106	$ 2,947	$ 9,273	$ 8,618
INTEREST AND OTHER EXPENSE, NET:				
Corrections Division	$ (417)	$ (252)	$ (859)	$ (914)
SpeakEZ Division	(317)	(227)	(901)	(681)
Internet Services Division	—	—	—	—
	$ (734)	$ (479)	$(1,760)	$ (1,595)
SEGMENT EARNINGS (LOSS) BEFORE INCOME TAXES:				
Corrections Division	$ 899	$(5,880)	$(1,745)	$ (7,507)
SpeakEZ Division	(759)	(802)	(2,272)	(2,626)
Internet Services Division	1,414	—	3,325	—
	$ 1,554	$(6,682)	$ (692)	$(10,133)

	September 30, 2000	December 31, 1999
	(Amounts in Thousands)	
SEGMENT ASSETS:		
Corrections Division	$71,300	$66,534
SpeakEZ Division	2,375	3,599
Internet Services Division	209	—
	$73,884	$70,133

There was no intersegment revenue for the three months ended September 30, 2000 and 19
Consolidated total assets included eliminations of approximately $12.9 million and $13.0 million as
September 30, 2000 and December 31, 1999, respectively. Eliminations consist of intercompany receivable
the Corrections Division and intercompany payables in the SpeakEZ Division related solely to intercomp
borrowing of the SpeakEZ Division.

Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

For a comprehensive understanding of our financial condition and performance, this discussion should be considered in the context of the condensed consolidated financial statements and accompanying notes and other information contained herein.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q includes forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, those listed under the caption "Risk Factors" in the Company's Form 10-K for the year ended December 31, 1999, which may affect the potential technological obsolescence of existing systems, the renewal of existing site specific Corrections and Internet Service Division customer contracts, the ability to retain the base of current site specific customer contracts, the ability to perform under contractual performance requirements, the continued relationship with existing customers, the ability to win new contracts for our products and services, including Lock & Track™, Contain® and our Internet Services Division, the ability of our existing customers, including AT&T, to maintain their market share of the inmate calling market, our ability to penetrate the market for jail management systems and to successfully license voice verification and fraud prevention technology, the effect of economic conditions, the effect of regulation, including the Telecommunications Act of 1996 that could affect our sales or pricing, the impact of competitive products and pricing particularly in the our Corrections Division, our continuing ability to develop hardware and software products, commercialization and technological difficulties, manufacturing capacity and product supply constraints or difficulties, actual purchases by current and prospective customers under existing and expected agreements, and the results of financing efforts, along with the other risks detailed therein.

Overview

Acquisition of Gateway Technologies, Inc.

On June 14, 1999, we completed our merger with Gateway Technologies, Inc. or "Gateway" by exchanging 3,672,234 shares of our common stock for all of the common stock of Gateway. Each share of Gateway was exchanged for 5.0375 shares of our common stock. In addition, outstanding Gateway stock options were converted at the same exchange rate into options to purchase approximately 379,000 shares of our common stock.

The merger constituted a tax-free reorganization and has been accounted for as a pooling of interests under Accounting Principles Board Opinion No. 16. Accordingly, all prior period information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations has been restated to include the combined results of operations, financial position and cash flows of T-NETIX and Gateway as though Gateway had always been a part of T-NETIX

In addition, in connection with the merger transaction, T-NETIX issued 375,341 shares of common stock to certain shareholders of Gateway in exchange for their terminating a royalty agreement with Gateway. The royalty agreement related to automated call processing technology and intellectual property rights that were assigned to Gateway by the royalty owners in exchange for royalty payments. The termination of the royalty owners' interests resulted in the acquisition of an intangible asset. The asset has been recorded at its estimated fair value, or $2,487,000. The fair value is based on the value of T-NETIX common stock at February 10, 1999 (date of the Merger Agreement), or $6.625, multiplied by the number of shares issued in exchange for termination of the royalty owners' interests. The intangible asset has an estimated useful life of 10 years, the remaining term of the underlying patent.

Corrections Division

In the Corrections Division we derive revenue from three main sources: telecommunications servic direct call provisioning and equipment sales. Each form of revenue has specific and varying operating co associated with such revenue. The Corrections Division accounted for approximately 75% of the Compan total revenue for the three and nine months ended September 30, 2000. Selling, general and administrat expenses, along with research and development and depreciation and amortization are common expen regardless of the revenue generated.

Telecommunications services revenue is primarily generated under long-term contracts from three to f years in length. Pricing historically provided for transaction fees to be paid on a per-call basis where we a paid a prescribed fee for each call completed and additional fees for validating phone numbers dialed inmates. The per-call charge is primarily for the provisioning of specialized call processing services telecommunications service providers for their correctional facilities customers. However, recently we enter into a contract amendment and a new price commitment with two significant customers to record revenue a percentage of gross revenue earned by the customer, subject to certain adjustments. This new pricing was effort by us to have our pricing remain flexible and not be effected by factors that affected call volum Pursuant to the actual and pending amendment, we also recognized certain telecommunications expenses th were previously reimbursable charges to these customers. In addition, during the current period we reache new pricing commitment with another of our customers that significantly increased the per-call rate. O telecommunications service provider customers include AT&T, Verizon, Qwest, SBC Communicatio BellSouth, and Sprint.

As a direct inmate call provider, we buy "wholesale" call services to be re-sold as collect calls. We use services of third parties to bill the collect calls. We then enter into direct contracts with the correctio facilities and generally pay to the correctional facilities commissions on the gross billed revenue. The ra charged by us are consistent with the collect call rates charged by the incumbent local exchange carrier "ILEC" in the same service area and the predominant interexchange carrier or "IXC." Since all c originating from the inmate phones are collect calls, each phone generates higher-than-industry-avera revenues. The uncertainty of the creditworthiness of the billed parties results however in a higher-tha industry-average uncollectible cost.

Equipment sales and other revenue includes the sales of our inmate calling system and the DRS syste The sales of the inmate calling system are generally made to only one customer. We then charge mont maintenance fees to keep the system operational. Sales to this customer can vary depending upon the succ of the customer in winning contracts with correctional facilities.

Internet Services Division

In December 1999, we entered into a master service agreement with US WEST INTERPRI America, Inc. to provide interLATA Internet services to Qwest customers. The contract, which commenc December 1, 1999, calls for us to buy, resell and process billings of Internet bandwidth to these custome The contract with Qwest is for a minimum of sixteen months.

The Internet Services Division accounted for approximately 25% of the Company's total revenue for three and nine months ended September 30, 2000. Our gross margin on these services was 19% and 17% the three and nine months ended September 30, 2000, respectively. The gross margin is effected by negotiated base management fee and contract incentive payments. The costs associated with this contract primarily the costs for Internet bandwidth. There were no capital outlays required to begin provisioning th services. The Company anticipates adding personnel to expand the service offerings of the Internet Servi Division beyond the scope of the current contract.

Extension of the contract beyond the minimum sixteen-month period is dependent upon the regulat approval process in various states. In the event that Qwest receives regulatory approval to provide interLA telecommunications services during or after the initial sixteen month period, our Internet Services reve could be reduced significantly or eliminated.

Speaker Verification Division

In our SpeakEZ Division the marketing strategy has been directed a technology licensing strategy versus a direct customer strategy. A direct customer sales strategy markets a specifically developed software product to specific end user customers. The strategy is then to find other specific customers who have similar operating systems and market this product to these customers. In contrast, a technology licensing strategy focuses on a larger scale customer who can integrate the SpeakEZ software product into its existing product line. This larger customer, such as a computer manufacturer, would then be responsible for the product integration and ultimate delivery to the end user customer. In keeping with this strategy, the SpeakEZ Division entered into an OEM Agreement to license its SpeakEZ technology to a major speech recognition company.

Even with the changes in marketing strategy, there can be no assurance that the products based on the SpeakEZ technology will achieve the necessary market acceptance or become widely adopted. The market for speaker verification software has only recently begun to develop. As is typical in the case of a new and rapidly evolving market, demand and market acceptance for recently introduced products and services are subject to a high level of uncertainty. Our voice print revenue has been minimal to date.

Results of Operations for the Three Months Ended September 30, 2000 Compared to September 30, 1999

The following table sets forth certain statement of operations data as a percentage of total revenue for the three months ended September 30, 2000 and 1999.

	2000	1999
Revenue:		
Telecommunications services	50%	58%
Direct call provisioning	23	41
Internet services	25	—
Equipment sales and other	2	1
Total revenue	100	100
Expenses:		
Operating costs	60	65
Selling, general and administrative	17	21
Research and development	4	6
Impairment of telecommunication assets	—	28
Depreciation and amortization	11	17
Operating income (loss)	8	(37)
Interest and other expense	(3)	(3)
Income (loss) before income taxes	5	(40)
Income tax (expense) benefit	—	—
Net income (loss)	5	(40)
Accretion of discount on redeemable convertible preferred stock	(2)	—
Net income (loss) applicable to common stock	3%	(40)%

Total Revenue. Total revenue for the three months ended September 30, 2000 was $29.3 million, an increase of 75% over $16.8 million for the corresponding prior period. This increase was primarily attributable to the commencement of Internet services, as well as increases in telecommunications services revenue.

The 50% increase in telecommunications services revenue to $14.6 million in the three months ended September 30, 2000, from $9.8 million for the corresponding prior period, was due primarily to an increase in contract prices. We changed our pricing to two significant customers whereby revenue is calculated as a percentage of our customer's gross revenue versus a transaction fee per call and increased the per-call rate to another customer. In addition we experienced an increase in revenue due to call volume increases, primarily due to the addition of new sites.

Direct call provisioning revenue was $6.8 million for the three months ended September 30, 20[illegible] 1999 respectively. There was no change in direct provisioning revenue as additions of new sites were of[illegible] the loss of other sites. The addition of sites is primarily a result of our being successful in competitive b[illegible] arrangements for contracts directly with correctional institutions. Conversely as contracts with corre[illegible] institutions expire, due to the competitive bidding process some sites, have been lost to competitors.

The Internet Services contract commenced in December 1999. Future revenue is dependent up[illegible] base of subscribers and contract incentive payments. Internet gross margin for the three months [illegible] September 30, 2000 was 19%. This contract is scheduled to expire March 31, 2001.

Equipment sales and other revenue increased 160% to $494,000 for the three months ended Se[illegible]ber 30, 2000 from $190,000 in the corresponding prior period. Such sales are primarily associated wi[illegible] telecommunications service provider customer and are dependent upon the timing of installations f[illegible] customer and the customer's success rate in its territory. In the three months ended September 30[illegible] significantly all of our equipment sales were to this telecommunications service provider customer. We [illegible] expect significant equipment sales in the near future.

Operating costs. Total operating costs were $17.5 million in the three months ended Septem[illegible] 2000, an increase of 61% from $10.8 million in the corresponding prior period. The increases were pr[illegible] due to the commencement of Internet services as well as increases in telecommunication services.

Operating costs of telecommunications services primarily consist of service administration co[illegible] correctional facilities, including salaries and related personnel expenses, communication costs and [illegible] calling systems repair and maintenance expense. Operating costs of telecommunications services also [illegible] costs associated with call verification procedures, primarily network expenses and database access c[illegible] Operating costs associated with direct call provisioning include the costs associated with telephone line[illegible] long distance charges, commissions paid to correctional facilities, costs associated with uncollectible a[illegible] and billing charges. Internet Services expense consists of Internet bandwidth costs. Cost of equipme[illegible] and other includes primarily the purchase price of equipment which is resold. Other equipme[illegible] components were minimal. Voice print operating costs include royalty charges, the cost of hardware [illegible] cost of services which amounts are reflected as other operating costs.

The following table sets forth the operating costs and expenses for each type of revenue as a perce[illegible] corresponding revenue for the three months ended September 30, 2000 and 1999.

	2000
Operating costs:	
Telecommunications services	37%
Direct call provisioning	89
Internet services	81
Cost of equipment sold and other	21

Operating costs associated with providing telecommunications services as a percentage of corre[illegible] revenue was 37% for the three months ended September 30, 2000, a decrease from 46% for the corre[illegible] prior period. The decrease was due primarily to revenue increases in excess of cost increase[illegible] telecommunications services operating expenses were $5.4 million for the three months ended Septe[illegible] 2000 and $4.5 million for the corresponding prior period. The increase in 2000 is due to increases in p[illegible] costs as a result of increased personnel and to a lesser extent, increases in salaries and wages. [illegible] addition of contract labor personnel in the National Service Center and other operational support [illegible] contributed to cost increases. To a lesser extent, increases in travel and communications expenses co[illegible] to the overall cost increase. With the addition of personnel at our National Service Center we believ[illegible] reduce field operations personnel costs in the near future.

Direct call provisioning costs as a percentage of applicable revenue decreased slightly to 89% o[illegible] for the three months ended September 30, 2000 from 92% for the corresponding prior period. Th[illegible] include increases due to site commissions and transmissions costs offset by a reduction in bad debt expense because of improved collections efforts.

The contract for Internet services commenced in December 1999. Future revenue increases are dependent upon the base of subscribers and additional contract incentive payments. Cost of equipment sold and other increased in the three months ended September 30, 2000 and also decreased as a percentage of corresponding revenue from the corresponding prior primarily due to the change in the revenue mix of equipment sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $5.1 million for the three months ended September 30, 2000 compared to $3.4 million for the corresponding prior period. Selling, general and administrative expenses associated with the Corrections Division were $5.0 million for the three months ended September 30, 2000 compared to $3.3 million in the corresponding prior period. The increase in the three months ended September 30, 2000 was primarily due to increases in salary and benefits for additional personnel and from raises for existing personnel. Other expenses, including travel and professional fees, increased due to the integration of Gateway's operations.

Research and Development Expenses. Research and development expenses were $1.2 million in the three months ended September 30, 2000 compared to $1.1 million for the corresponding prior period. Research and development expenses for the Corrections Division were $1.1 million in the three months ended September 30, 2000 and $0.9 million in the corresponding prior period. The increase was primarily due to increased personnel expenses. We anticipate research and development expenses to remain consistent for the remainder of the year.

Depreciation and Amortization Expenses. Depreciation and amortization expense was $3.1 million in the three months ended September 30, 2000, an increase from $2.9 million for the corresponding prior period. The increase was due primarily to the depreciation associated with new site installations and additional equipment purchased for internal operations.

Interest and Other Expense, Net. Interest and other expense, net was $734,000 for the three months ended September 30, 2000, an increase from $479,000 for the corresponding prior period. Included in other income in the three months ended September 30, 2000 is a gain of approximately $79,000 on the sale of used telecommunications equipment. Interest expense was $813,000 for the three months ended September 30, 2000, and $479,000 for the corresponding prior period. The increase in 2000 was attributable to an increase in the average amount of indebtedness outstanding and an increase in interest rates. The average debt balance increased primarily due to the increase in capital expenditures.

Results of Operations for the Nine Months Ended September 30, 2000 Compared to September 30,

The following table sets forth certain statement of operations data as a percentage of total revenue for the nine months ended September 30, 2000 and 1999.

	2000	1999
Revenue:		
Telecommunications services	46%	57%
Direct call provisioning	27	39
Internet services	25	—
Equipment sales and other	2	4
Total revenue	100	100
Expenses:		
Operating costs	65	63
Selling, general and administrative	17	19
Research and development	5	7
Impairment of telecommunication assets	—	9
Depreciation and amortization	12	16
Operating income (loss)	1	(14)
Merger transaction expenses	—	(2)
Interest and other expense	(2)	(3)
Loss before income taxes	(1)	(19)
Income tax benefit	—	2
Net loss	(1)	(17)
Accretion of discount on redeemable convertible preferred stock	(1)	—
Net loss applicable to common stock	(2)%	(17)%

Total Revenue. Total revenue for the nine months ended September 30, 2000 was $79.6 million increase of 52% over $52.3 million for the corresponding prior period. This increase was primarily attribut to the commencement of Internet services, as well as increases in telecommunications services revenue direct call provisioning revenue, offset in part by decreases in equipment sales and other.

The 24% increase in telecommunications services revenue to $36.7 million in the nine months en September 30, 2000, from $29.6 million for the corresponding prior period, was due primarily to an increas contract prices. In addition we experienced an increase in revenue due to call volume increases, primarily to the addition of new sites.

Direct call provisioning revenue increased 5% to $21.3 million for the nine months ended September 2000, from $20.3 million in the corresponding prior period. This increase was primarily due to the additio new sites for which we are provisioning the long distance service. The addition of sites is a result of our b successful in competitive bidding arrangements for contracts directly with correctional institutions.

The Internet Services contract commenced in December 1999. Future revenue increases are depen upon the base of subscribers and additional contract incentive payments.

Equipment sales and other revenue decreased 26% to $1.7 million for the nine months en September 30, 2000 from $2.3 million in the corresponding prior period. Such sales are primarily associ with one telecommunications service provider customer and are dependent upon the timing of installation this customer and the customer's success rate in its territory. In the nine months ended September 30, 2 significantly all equipment sales were to this telecommunications service provider customer. The reduction the nine months ended September 30, 2000 from the corresponding prior period is due primarily to the tim of purchases by this customer.

Operating costs. Total operating costs were $51.8 million in the nine months ended September 30, 2000, an increase of 58% from $32.9 million in the corresponding prior period. The increases were primarily due to the commencement of Internet services as well as increases in telecommunication services and direct call provisioning expenses offset by a reduction in the cost of equipment sold and other expenses.

Operating costs of telecommunications services primarily consist of service administration costs for correctional facilities, including salaries and related personnel expenses, communication costs and inmate calling systems repair and maintenance expense. Operating costs of telecommunications services also include costs associated with call verification procedures, primarily network expenses and database access charges. Operating costs associated with direct call provisioning include the costs associated with telephone line access, long distance charges, commissions paid to correctional facilities, costs associated with uncollectible accounts and billing charges. Internet Services operating expense consists of purchased internet bandwidth costs.

The following table sets forth the operating costs and expenses for each type of revenue as a percentage of corresponding revenue for the nine months ended September 30, 2000 and 1999.

	2000	1999
Operating costs:		
Telecommunications services	42%	44%
Direct call provisioning	91	93
Internet services	83	—
Cost of equipment sold and other	39	40

Operating costs associated with providing telecommunications services as a percentage of corresponding revenue was 42% for the nine months ended September 30, 2000, a decrease from 44% for the corresponding prior period. The decrease was due to revenue increases in excess of cost increases. Total telecommunications services operating expenses were $15.3 million for the nine months ended September 30, 2000 and $13.2 million for the corresponding prior period. The increase in 2000 is due to new services being provisioned for a significant customer as part of a contract amendment and due to increases in personnel costs. The increase included bonus costs associated with our line installation bonus program. The bonus program ended as of June 30, 2000. Also, the addition of new personnel in the National Service Center and other operational support functions contributed to cost increases. To a lesser extent, increases in travel, consulting services, repairs and maintenance contributed to the overall cost increase.

Direct call provisioning costs as a percentage of applicable revenue decreased to 91% of revenue for the nine months ended September 30, 2000 from 93% in for the corresponding prior period. This decrease was primarily due to a reduction in bad debt expense because of improved collections efforts.

The contract for Internet services commenced in December 1999. Cost of equipment sold and other decreased in the nine months ended September 30, 2000 but increased as a percentage of corresponding revenue from the corresponding prior primarily due to the change in the revenue mix for equipment sales and voice print sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $13.4 million for the nine months ended September 30, 2000 compared to $9.9 million for the corresponding prior period. Selling, general and administrative expenses associated with the Corrections Division were $13.1 million for the nine months ended September 30, 2000 compared to $9.3 million in the corresponding prior period. The increase in the nine months ended September 30, 2000 was primarily due to increases in salary and benefits for additional personnel, from raises for existing personnel and a bonus program. Other expenses increased due to travel, communications and professional fees due to the integration of Gateway operations.

Research and Development Expenses. Research and development expenses were $4.0 million in the nine months ended September 30, 2000 compared to $3.7 million for the corresponding prior period. Research and development expenses for the Corrections Division were $3.6 million in the nine months ended September 30, 2000 and $3.0 million in the corresponding prior period. The increase was primarily due to higher travel and consulting costs.

Depreciation and Amortization Expenses. Depreciation and amortization expense was $9.3 milli the nine months ended September 30, 2000, an increase from $8.6 million for the corresponding prior p The increase was due primarily to the depreciation associated with new site installations.

Merger Transaction Expenses. These expenses were directly related to the merger with Gateway amounted to approximately $1.0 million for the nine months ended September 30, 1999. Merger transa expenses consisted primarily of fees for investment bankers, attorneys, accountants, financial printing other related charges.

Interest and Other Expense, Net. Interest and other expense, net was $1.8 million for the nine m ended September 30, 2000, an increase from $1.6 million for the corresponding prior period. Included in income in the nine months ended September 30, 2000 is a gain of approximately $283,000 on the sale of telecommunications equipment. There was $59,000 of miscellaneous other income in the nine months e September 30, 1999. Interest expense was $2.2 million for the nine months ended September 30, 2000 $1.7 million for the corresponding prior period. The increase in 2000 was attributable to an increase i average amount of indebtedness outstanding and an increase in interest rates. The average debt ba increased primarily due to the increase in capital expenditures and business acquisitions.

Liquidity and Capital Resources

Cash Flows

We incurred losses from operations for the nine months ended September 30, 2000 of $795,000 and h working capital deficit of $28.1 million at September 30, 2000. In July 2000 our lenders amended our c agreement to provide for revised financial covenants. Additionally, we raised $7.5 million of debt and e financing in April 2000. The net proceeds were used to reduce the outstanding balance on our credit fac We have taken steps to improve our cash flow from operations, including renegotiating contract pricing cost control measures in order to carry out the remainder of our fiscal 2000 business plan. We have increases in our cash flow from operating income which will allow for higher levels of borrowings unde current loan agreement. This credit facility is expected to provide the borrowing capacity necessary to continuing operational needs through April 30, 2001.

We have historically relied upon commercial borrowings, operating cash flow and the sale of e securities to fund our operations and capital needs. Investing activities consist primarily of addition property and equipment for site telecommunications equipment and internal equipment requirements. C provided by operations decreased 63% to $2.9 million for the nine months ended September 30, 2000 f $7.8 million in the corresponding prior period primarily due to reductions in accounts payable, and increas accounts receivable. The increase in the working capital deficit is primarily due to the reclassification of bank credit facility as a current liability. The current maturity date of the facility is April 30, 2001.

Purchases of property and equipment were $10.2 million in the nine months ended September 30, 2 compared to $10.1 million for the corresponding prior period. The increase in purchases of property equipment was primarily due to additional inmate calling system installations and upgrades to exis systems.

Debt and Equity

We have been funding our operations primarily from available borrowings under a line of credit an using cash provided by operations. Due to our capital requirements for new installations and the merger Gateway, in September 1999, we entered into a Senior Secured Revolving Credit Facility ("Credit Facili with a commercial bank. The maximum available amount of credit under the credit facility available to Company is dependent upon the Company's financial performance. Based on the financial covenants, Company's maximum borrowings at September 30, 2000 were $34.3 million. In July 2000 our len amended our credit agreement to revise certain financial covenants. In addition, we raised $7.5 million of and equity financing in April 2000. The net proceeds of approximately $7.2 million were used to reduce outstanding balance on the Credit Facility.

We anticipate that our capital expenditures in 2000 will be consistent with 1999 based on our anticipated growth in installed systems at correctional facilities. We believe our Credit Facility and cash flows from operations will be sufficient in order for us to meet our anticipated cash needs for anticipated new installations of inmate call processing systems and upgrades of existing systems and to finance our operations for at least the next 6 months.

Item 3. *Quantitative and Qualitative Disclosure About Market Risk*

We are exposed to interest rate risk as discussed below.

Interest Rate Risk

We have current debt outstanding under the credit facility of $29.4 million at September 30, 2000. The credit facility bears interest at differing rates including, $23.5 million at LIBOR plus 2.75 % and the remaining balance at the prime rate, 9.5% at September 30, 2000, plus 0.5%. Interest on the LIBOR rate loan and prime rate loans are payable monthly. Since the interest rates on the loans outstanding are variable and are reset periodically, we are exposed to interest rate risk. An increase in interest rates of 1% would increase estimated annual interest expense by approximately $280,000 based on the amount of borrowings outstanding under the line of credit at September 30, 2000.

PART II OTHER INFORMATION

Item 1. ***Legal Proceedings***

From time to time we have been, and expect to continue to be subject to various legal and administrative proceedings or suits in the normal course of our business.

Gateway recently won a dismissal of a case brought in the First Judicial District Court of the State of New Mexico, styled *Valdez v. State of New Mexico, et al.* That case named as defendants the State of New Mexico, several political subdivisions of the State of New Mexico and several inmate telecommunications service providers, including Gateway. The complaint includes a request for certification by the court of a plaintiffs' class action consisting of all persons who have been billed for and paid for telephone calls initiated by an inmate confined in a jail, prison, detention center or other New Mexico correctional facility. The complaint alleges violations of New Mexico Unfair Practices Act, the New Mexico Antitrust Act and the New Mexico Constitution, and also alleges unjust enrichment, constructive trust, economic compulsion, constructive fraud and illegality of contracts, all in connection with the provision of "collect only" inmate telecommunications services. The case was never certified as a class action. The Plaintiffs have indicated a readiness to appeal the dismissal of the case, although they have not done so to date.

Similarly, T-Netix is likely to win dismissal of another state case brought in the Superior Court of Washington for King County, styled *Sandy Judd, et al. v. American Telephone and Telegraph Company, et al.* In that case, the complaint joined several inmate telecommunications service providers as defendants, including T-NETIX. The complaint includes a request for certification by the court of a plaintiffs' class action consisting of all persons who have been billed for and paid for telephone calls initiated by an inmate confined in a jail, prison, detention center or other Washington correctional facility. The complaint alleges violations of the Washington Consumer Protection Act (WCPA) and requests an injunction under the Washington Consumer Protection Act and common law to enjoin further violations. The court has held that the complaint fails to state a valid claim under the WCPA and has granted plaintiffs leave to amend the complaint to address this infirmity. Regardless of the merits of the amended claim, the judge has ruled that it has no jurisdiction to adjudicate the matter and will refer the claim to the Washington Utilities and Transportation Commission for disposition.

Gateway is presently litigating an appeal from a similar favorable ruling in Kentucky federal court in the case *Gus "Skip" Daleure, Jr., et al. vs. Commonwealth of Kentucky, et al.* The complaint in this case joined as defendants several states, political subdivisions of states, and inmate service telecommunications providers and was filed contemporaneously with a request for certification by the court of a nationwide plaintiffs' class action consisting of all persons who have received and paid for telephone calls initiated by an inmate at a prison, jail or other correctional institution for the provision of "collect only" inmate telecommunications services. The complaint sought declaratory and injunctive relief and money damages in an unstated amount for alleged violations of the Sherman Antitrust Act, the Robinson-Patman Act and the U.S. Constitution. The district court held, on motions to dismiss: Kentucky did not have personal jurisdiction over defendants not located in or doing business in the state of Kentucky; that telephone calls are not goods or commodities and thus are not subject to the antitrust provisions of the Robinson-Patman Act; that Plaintiffs did not state a claim for relief under the Equal Protection Clause of the Fourteenth Amendment; and that Plaintiffs had not shown any harm in support of its antitrust claim under Section 1 of the Sherman Act. The trial judge did not, however, dismiss the plaintiff's prayer for injunctive relief, despite these findings. The case is currently subject to appeal and cross appeal in the Second Circuit Court of Appeals. Although Gateway believes the District Court holding will not be overturned it is possible that it may be, and there can be no assurance that a judgment against a class of the providers will not ultimately be entered.

We believe the ultimate disposition of the forgoing matters will not have a material affect on our financial condition, liquidity, or results of operations.

Item 2. ***Changes in Securities and Use of Proceeds***

None

Item 3. ***Defaults Upon Senior Securities***

None.

Item 4. ***Submission of Matters to a Vote of Security Holders***

None.

Item 5. ***Other Information***

None.

Item 6. ***Exhibits and Reports on Form 8-K***

(a) Exhibits

27 — Financial Data Schedule

(b) The Company filed a Form 8-K dated August 28, 2000 reporting the following: Item 5 on Form 8-K regarding resignation of chief executive officer and director.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

T-NETIX, INC.
(Registrant)

By: /s/ THOMAS E. LARKIN
Thomas E. Larkin
President

By: /s/ JOHN GIERSCHER
John Gierscher
Principal Accounting Officer

Date November 13, 2000

EXHIBIT E - PROPOSED TARIFF

TARIFF APPLICABLE TO

ALTERNATE OPERATOR SERVICES

WITHIN THE STATE OF SOUTH DAKOTA

PROVIDED BY

T-NETIX TELECOMMUNICATIONS SERVICES, INC.

Issued by: Richard Cree, President
1544 Valwood Parkway, Suite 102
Carrollton, Texas 75006

TITLE SHEET

SOUTH DAKOTA TELECOMMUNICATIONS TARIFF

This tariff contains the descriptions, regulations, and rates applicable to the furnishing of service or facilities for Telecommunications Services furnished by T-NETIX Telecommunications Services, Inc. ("T-NETIX"), with principal offices at 1544 Valwood Parkway, Suite 102, Carrollton, Texas 75006. This tariff applies for services furnished within the State of South Dakota. This tariff is on file with the South Dakota Public Utilities Commission, and copies may be inspected, during normal business hours, at the company's principal place of business.

CONCURRING, CONNECTING OR

OTHER PARTICIPATING CARRIERS

1. Concurring Carriers - None

2. Connecting Carriers - None

3. Other Participating Carriers - None

CHECK SHEET

The Sheets of this tariff are effective as of the date shown at the bottom of the respective sheet(s). Original and revised sheets as named below comprise all changes from the original tariff and are currently in effect as of the date on the bottom of this sheet.

SHEET	REVISION
1	Original
2	Original
3	Original
4	Original
5	Original
6	Original
7	Original
8	Original
9	Original
10	Original
11	Original
12	Original
13	Original
14	Original
15	Original
16	Original
17	Original
18	Original
19	Original
20	Original
21	Original
22	Original
23	Original

* - New or Revised Sheet

Issued: Effective:

Issued by: Richard Cree, President
1544 Valwood Parkway, Suite 102
Carrollton, Texas 75006

TABLE OF CONTENTS

SYMBOLS

The following are the only symbols used for the purposes indicated below:

D - Delete or Discontinue

I - Change Resulting In An Increase to A Customer's Bill

M - Moved from Another Tariff Location

N - New

R - Change Resulting In A Reduction to A Customer's Bill

T - Change in Text or Regulation But No Change In Rate or Charge

TARIFF FORMAT

A. **Sheet Numbering** - Sheet numbers appear in the upper right corner of the page. Sheets are numbered sequentially. When a new sheet is added between sheets already in effect, a decimal is added. For example, a new sheet added between sheets 14 and 15 would be 14.1.

B. **Sheet Revision Numbers** - Revision numbers also appear in the upper right corner of each page. These numbers are used to determine the most current sheet version on file with the Commission. For example, the 4th revised Sheet 14 cancels the 3rd revised Sheet 14. Consult the Check Sheet for the sheet currently in effect.

C. **Paragraph Numbering Sequence** - There are nine levels of paragraph coding. Each level of coding is subservient to its next higher level:

2.
2.1.
2.1.1.
2.1.1.A.
2.1.1.A.1.
2.1.1.A.1.(a).
2.1.1.A.1.(a).I.

D. **Check Sheets** - When a tariff filing is made with the Commission, an updated Check Sheet accompanies the tariff filing. The Check Sheet lists the sheets contained in the tariff, with a cross reference to the current revision number. When new sheets are added, the Check Sheet is changed to reflect the revision. All revisions made in a given filing are designated by an asterisk (*). There will be no other symbols used on this sheet if these are the only changes made to it (i.e., the format, etc. remain the same, just revised revision levels on some sheets.)

SECTION 1 - TECHNICAL TERMS AND ABBREVIATIONS

Commission - South Dakota Public Utilities Commission.

Auto-Collect Call - A billing arrangement by which the charges for a call may be billed to the called party without the intervention of a live operator, provided the called party agrees to accept the charges. The Called Party is responsible for charges associated with the call.

Automated Person-to-Person Collect Call - A service in which the caller may designate a specific individual, station number or extension with whom he or she wishes to speak. Call charges do not begin until the caller acknowledges the called party or an agreed upon alternate. The Called Party is responsible for charges associated with the call.

Called Party - The person, individual, corporation or other entity whose telephone number is called. The Called Party is responsible for payment of the charges for use of T-NETIX's automated collect service.

Company or Carrier - T-NETIX Telecommunications Services, Inc. unless otherwise clearly indicated by the context.

Confinement Facilities - Prisons, jails, correctional institutions or other places of confinement used for penalty purposes. Confinement Facilities are Subscribers of T-NETIX's services and make the service available to Inmates.

Consumer or Customer - A person, firm, partnership, corporation or other entity which arranges for the Company to provide, discontinue or rearrange telecommunications services on behalf of itself or others; uses the Company's telecommunications services; and is responsible for payment of charges, all under the provisions and terms of this price list. Includes the inmates of Correctional Institutions and parties who accept charges for calls placed from Correctional Institutions served by the Company.

SECTION 1 - TECHNICAL TERMS AND ABBREVIATIONS, CON'T.

T-NETIX - Used throughout this tariff to refer to T-NETIX Telecommunications Services, Inc.

Inmates - The jailed population of Confinement Facilities. Inmates are users of T-NETIX's system.

LEC - Local Exchange Company.

V & H Coordinates - Geographic points which define the originating and terminating points of a call in mathematical terms so that the airline mileage of the call may be determined. Call mileage is used for the purposed of rating calls.

SECTION 2 - RULES AND REGULATIONS

2.1 Undertaking of the Company

T-NETIX's services and facilities are furnished for communications originating at specified points within the state of South Dakota under terms of this tariff.

T-NETIX installs, operates, and maintains the communications services provided herein under in accordance with the terms and conditions set forth under this tariff. Service is provided to Confinement Facilities for use by Inmates. T-NETIX may act as the Confinement Facility's agent for ordering access connection facilities provided by other carriers or entities, when authorized, to allow connection of a Confinement Facility's location to the T-NETIX network.

The Company's services and facilities are provided on a monthly basis unless otherwise provided, and are available twenty-four hours per day, seven days per week.

2.2 Limitations

2.2.1 Service is limited to "0+" collect calling for local, intraLATA and interLATA calls.

2.2.2 Service is offered subject to the availability of the necessary facilities and equipment, or both facilities and equipment, and subject to the provisions of this tariff.

2.2.3 T-NETIX reserves the right to discontinue or limit service when necessitated by conditions beyond its control, or when service is used in violation of provisions of this tariff, or in violation of the law.

SECTION 2 - RULES AND REGULATIONS, CON'T.

2.2 Limitations, con't.

2.2.4 The company does not undertake to transmit messages, but offers the use of facilities when available, and will not be liable for errors in transmission or for failure to establish connections.

2.2.5 Service provided to Correctional Facilities for use by Inmates may be otherwise limited by the administration of the institution at its discretion.

2.3 Use

Services provided under this tariff may be used for any lawful purpose for which the service is technically suited subject to limitations imposed by the Correctional Facility.

2.4 {reserved for future use}

SECTION 2 - RULES AND REGULATIONS, CON'T.

2.5 Taxes

All state and local taxes (i.e., gross receipts tax, sales tax, municipal utilities tax) are listed as separate line items and are not included in the quoted rates.

2.6 Installation and Termination

Service is installed upon mutual agreement between the Confinement Facility and the Company. The service agreement does not alter rates specified in this tariff.

2.7 Billing and Payment For Service

A. Payment for Service

The Customer is responsible for payment of all charges for services and equipment furnished to the Customer or to an end user of the Customer by T-NETIX. All charges due by the Customer are payable to the Company or to any agency duly authorized to receive such payments (such as a local exchange company).

B. Disputed Charges

Charges billed directly by the Company are due upon receipt. Amounts not paid within 10 days of the invoice will be considered past due. For charges billed directly by the Company, notice from the Customer of a dispute as to charges must be received in writing by the Company within thirty (30) days after the date of the invoice. Otherwise, all charges will be considered correct and binding.

For charges billed through the Customer's local exchange carrier, notice from the Customer of disputed charges must be received in writing by the Company within ninety (90) days after the date of the bill is issued. Otherwise, all charges will be considered correct and binding on the Customer.

SECTION 2 - RULES AND REGULATIONS, CON'T.

2.7 Billing and Payment For Service, Con't.

B. Disputed Charges, con't.

The Company will promptly investigate and advise all billed parties as to its findings concerning disputed charges. Adjustments to Customer's bills shall be made to the extent that circumstances exist which reasonably indicate that such changes are appropriate. Customers may contact the South Dakota Public Utilities Commission in the event of an unresolved dispute at 500 East Capitol, Pierre, SD 57501-5070, (605) 773-3201, (800) 332-1782, TTY through Relay Service South Dakota-(800) 877-1113.

C. Validation of Credit

The Company reserves the right to validate the creditworthiness of Customers and billed parties through available verification procedures and to establish a maximum predetermined credit amount. Where a requested billing method cannot be validated or maximum credit amount established, the Company may refuse to provide service.

Services provided by the Company are available to inmates of confinement facilities in accordance with facility-authorized programs. The Company may request that the confinement facility adopt, as part of its program, terms that enable the Company to collect the charges for all inmate calls, including without limitation, the blocking of calls by the Company to certain telephone numbers when the amount charged to such a telephone number exceeds a predetermined amount or becomes past due.

D. Advance Payments

The Company does not normally require advance payments for service. However, for Customers whom the Company determines an advance payment is necessary, T-NETIX reserves the right to collect an amount not to exceed two (2) month's estimated charges as an advance payment for service. This will be applied against the next month's charges and a new advance payment may be collected for the next month, if necessary.

SECTION 2 - RULES AND REGULATIONS, CON'T.

2.7 Billing and Payment For Service, Con't.

E. Deposits

The Company does not normally require deposits. However the company reserves the right to collect a deposit from customers whose credit history is unacceptable or unknown to the Company. Deposits, if collected, will be collected and maintained in accordance with Commission rules.

For services provided to inmates of confinement facilities, the Company may require a deposit from billed parties for charges which exceed a maximum credit amount predetermined by the Company based on the Customer's credit worthiness. The Customer may exceed this predetermined credit amount by first paying a deposit to the Company in an amount equal to the amount of additional credit authorization requested by the Customer.

F. Return Check Charge

A return check charge of $20.00 will be assessed for checks returned for insufficient funds. Any applicable return check charges will be assessed according to the terms and conditions of the Company or its billing agent and pursuant to South Dakota law.

SECTION 2 - RULES AND REGULATIONS, CON'T.

2.8 Refusal or Discontinuance by Company

T-NETIX may refuse or discontinue service under the following conditions. Unless otherwise specified, the Confinement Facility or Inmate will be given five (5) days written notice and allowed a reasonable time to comply with any rule or remedy any deficiency.

(a) For non-compliance with and/or violation of any State or municipal law, ordinance or regulation pertaining to telephone service.

(b) For the use of telephone service for any other property or purpose other than that described in the application.

(c) For neglect or refusal to provide reasonable access to the Company for the purpose of inspection and maintenance of equipment owned by the Company.

(d) For non-compliance with and/or violation of the Commission's regulations or the Company's rules and regulations on file with the Commission.

(e) For non-payment of bills for telephone service.

(f) Without notice in the event of use of equipment in such a manner as to adversely affect the Company's equipment or the Company's service to others.

(g) Without notice in the event of tampering with the equipment furnished and owned by the Company.

(h) Without notice in the event of unauthorized or fraudulent use of service. Whenever service is discontinued for fraudulent use of service, the Company may, before restoring service, require that all changes in facilities or equipment necessary to eliminate illegal use and to pay an amount reasonably estimated as the loss in revenues resulting from such fraudulent use.

SECTION 2 - RULES AND REGULATIONS, CON'T.

2.8 Refusal or Discontinuance by Company (continued)

(i) For failure of the Confinement Facility to make proper application for service.

(j) For Confinement Facility's breach of the contract for service between the Company and the Confinement Facility.

(k) When necessary for the Company to comply with any order or request of any governmental authority having jurisdiction.

2.9 Credit Allowance for Interruption of Service

Credit allowances for interruptions of service are limited to the initial minimum call charge for re-establishing the interrupted call.

2.10 Inspection, Testing and Adjustment

Upon reasonable notice, the facilities provided by the Company shall be made available to the Company for tests and adjustments as may be deemed necessary by the Company for maintenance. No interruption allowance will be granted for the time during which such tests and adjustments are made when the interruption is less than twenty-four consecutive hours.

2.11 Positive Acceptance of Calls

No charges shall be incurred by the Called Party unless the Called Party clearly and affirmatively indicates a willingness to accept and pay for the call.

SECTION 3 - DESCRIPTION OF SERVICE

3.1 General

Service is offered to Inmates of Confinement Facilities. Inmates may place collect calls using T-NETIX's service.

3.2 Timing of Calls

3.2.1 Long distance usage charges are based on usage of T-NETIX's network. The Company will determine that a call has been established through industry standard answer detection methods, including hardware answer detection.

3.2.2 Chargeable time for a call ends upon disconnection by either party.

3.2.3 The minimum call duration for billing purposes is one minute.

3.2.4 After the minimum call duration, calls are rounded up to the next higher full minute for billing purposes.

3.2.5 No charges apply for incomplete calls.

Issued by: Richard Cree, President
1544 Valwood Parkway, Suite 102
Carrollton, Texas 75006

SECTION 3 - DESCRIPTION OF SERVICE, CON'T.

3.3 Calculation of Distance

Usage charges for all mileage sensitive products are based on the airline distance between the rate centers associated with the originating and terminating points of the call.

The distance between the originating and terminating points is calculated by using the "V" and "H" coordinates of the rate centers, as defined by AT&T in its Tariff No. 10 as filed with the FCC in the following manner:

Step 1 - Obtain the "V" and "H" coordinates for the originating and terminating points of the call.

Step 2 - Obtain the difference between the "V" coordinates. Obtain the Difference between the "H" coordinates.

Step 3 - Square the differences obtained in Step 2.

Step 4 - Add the squares of the "V" difference and "H" difference obtained in Step 3.

Step 5 - Divide the sum of the square obtained in Step 4 by ten (10). Round to the next higher whole number if any fraction results from the division.

Step 6 - Obtain the square root of the whole number obtained in Step 5. Round to the next higher whole number if any fraction is obtained. This is the V&H mileage between the originating and terminating points of the call.

Formula:

SECTION 3 - DESCRIPTION OF SERVICE, CON'T.

3.4 T-NETIX's Automated Collect Operator Service

T-NETIX provides Automated Collect-Only Operator Service. Calls are billed to the Called Party. The Called Party must actively accept charges for the call. A per-call service charge applies to each call, the rate for which varies depending upon the class of the call.

Classes of Calls

Automated Collect Station Calls: are calls which are placed by an Inmate who dials all of the digits required to route the call and who follows the T-NETIX system prompts, enabling the Called Party to accept the charges for the call. If the Called Party does not accept the call, the call is terminated and no billing applies.

Automated Collect Person-to-Person Calls: are calls which are placed by an Inmate who dials all of the digits required to route the call and who follows the T-NETIX system prompts to place the call on a person-to-person basis (i.e. specify the person to which the call is being placed). The Called Party must accept responsibility for the charges. If the Called Party does not accept the call, the call is terminated and no billing applies.

Other Charges

Inmate Station Service Charge: applies to automated collect calls which are placed by inmates of correctional facilities when such calls are provided through T-NETIX Technologies' own processing equipment. This charge applies in addition to all applicable message charges and operator assistance service charges specified in this tariff.

SECTION 4 - RATES

4.1 General

Each call is billed individually to the party responsible for the charges. Charges are computed on an airline mileage basis as described in Section 3.3 of this tariff. The Called Party is billed based on their use of T-NETIX's long distance service.

The charges for T-NETIX services are determined by the:

- distance between stations
- duration of the call
- class of call
- jurisdictional nature of the call (intra v. interLATA)

4.2 Automated Operator Service Charges

All automated operator assisted calls are subject to operator service charges. These charges apply on a per call basis and will be added to the usage charges on the bill for service.

SECTION 4 - RATES, CON'T.

4.3 Schedule 1
T-NETIX Automated Operator IntraLATA Service

4.3.1 Auto-Collect Service Usage Rates

	DAY		EVENING		NIGHT/WEEKEND	
MILES	Initial Minute	Add'l Minute	Initial Minute	Add'l Minute	Initial Minute	Add'l Minute
ALL	$0.29	$0.29	$0.27	$0.27	$0.27	$0.27

	Per Call Charges
Per Call Service Charge	$2.25
Pay Phone Charge	$0.26
Local Charge	$2.45

SECTION 4 - RATES, CON'T.

4.3 Schedule 1, continued
T-NETIX Automated Operator InterLATA Service, continued

4.3.2 Automated Operator Service Charges

	DAY		EVENING		NIGHT/WEEKEND	
MILES	Initial Minute	Add'l Minute	Initial Minute	Add'l Minute	Initial Minute	Add'l Minute
ALL	$0.47	$0.47	$0.47	$0.47	$0.47	$0.47

	Per Call Charges
Per Call Service Charge	$3.00

SECTION 4 - RATES, CON'T.

4.3 Schedule 1, continued
T-NETIX Automated Operator IntraLATA Service, continued

4.4 Rate Periods: Time-of-Day and Holiday Periods
The following time of day periods apply to all rate schedules.

Day: Monday through Friday, 8AM to 4:59 PM

Evening: Sunday though Friday, 5PM to 10:59PM;

Night: 11PM to 7:59 AM every day
All day Saturday
Sunday 8AM to 4:59PM

Holiday: For recognized holidays, the evening rate applies unless a lower rate would normally apply. The following are Company recognized holidays.

New Year's Day	(January 1)
Martin Luther King Day	(as Federally Observed)
Thanksgiving Day	(as Federally Observed)
Christmas Day	(December 25)

South Dakota Public Utilities Commission
WEEKLY FILINGS
For the Period of April 19, 2001 through April 25, 2001

If you need a complete copy of a filing faxed, overnight expressed, or mailed to you, please contact Delaine Kolbo within five business days of this filing. Phone: 605-773-3705 Fax: 605-773-3809

CONSUMER COMPLAINTS

CT01-015 **In the Matter of the Complaint filed by Delores Denke, Rapid City, South Dakota, against Qwest Corporation Regarding Deceptive Practice.**

The Complainant alleges that she was not made aware of the distinction between interstate and intrastate providers. The Complainant further states that she was not aware that Qwest was her instate provider and feels that Qwest has taken advantage of her by not making it clear that they offered instate long distance automatically. The Complainant requests that Qwest be responsible for the charges on her phone bill and that Qwest notify all customers that there is a difference in instate and out of state providers.

Staff Analyst: Mary Healy
Staff Attorney: Kelly Frazier
Date Filed: 04/19/01
Intervention Deadline: N/A

TELECOMMUNICATIONS

TC01-043 **In the Matter of the Application of NOS Communications, Inc. for a Certificate of Authority to Provide Local Exchange Services in South Dakota.**

NOS Communications, Inc. (NOS) is seeking a Certificate of Authority to provide local exchange telecommunications services throughout South Dakota. NOS intends to offer all forms of local services, including measured, flat rate, PBX, Centrex, and value added service on a facilities-based and resold basis.

Staff Analyst: Heather Forney
Staff Attorney: Karen Cremer
Date Docketed: 04/19/01
Intervention Deadline: 05/11/01

TC01-044 **In the Matter of the Application of T-NETIX Telecommunications Services, Inc. for a Certificate of Authority to Provide Interexchange Telecommunications Services in South Dakota.**

T-NETIX Telecommunications Services, Inc (T-NETIX) is seeking a Certificate of Authority to provide intrastate interexchange telecommunications services throughout South Dakota. T-NETIX intends to offer specialized call processing and other services to the corrections industry. The services will be limited to collect calls initiated by inmates from coin telephones in correctional facilities. T-NETIX will offer call control features including: one-way, out-going only service, blocked access to "411", 800/888/877, 900 and other calls; caller ID blocking to outside parties, and call recording and management.

Staff Analyst: Heather Forney
Staff Attorney: Karen Cremer
Date Docketed: 04/23/01
Intervention Deadline: 05/11/01

Lance J.M. Steinhart, P.C.
Attorney At Law
6455 East Johns Crossing
Suite 285
Duluth, Georgia 30097

RECEIVED
APR 2 3 2001
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

Also Admitted in New York
and Maryland

Telephone: (770) 232-9200
Facsimile: (770) 232-9208

April 20, 2001

VIA OVERNIGHT DELIVERY

Delaine Kolbo
South Dakota Public Utilities Commission
500 East Capitol Avenue
Ave-Pierre, SD 57501-5070
(605) 773-3201

Re: T-NETIX Telecommunications Services, Inc.
Inmate Service Providers

Dear Mr. Bullard:

Enclosed is original check number 71699 in the amount of $250.00 payable to the "South Dakota Public Utilities Commission" for the filing fee. This check was inadvertently left out of our Application for Registration of a Telecommunications Company sent via Federal Express on April 11, 2001.

Also enclosed is an extra copy of this cover letter to be date stamped and returned to me in the enclosed self-addressed prepaid envelope.

If you have any questions or if I may provide you with any additional information, please do not hesitate to contact me.

Respectfully submitted,

Christa L. Fallin
Legal Assistant to
Lance J.M. Steinhart
Attorney for T-NETIX Telecommunications Services, Inc.

Enclosures

T-NETIX, INC.
67 INVERNESS DRIVE EAST
ENGLEWOOD, CO 80112
(303) 790-9111

Check No. - 71699
Check Date - 04/13/01

DETACH STATEMENT BEFORE DEPOSITING

Stub 1 of 1

INVOICE NUMBER	DATE	DESCRIPTION	GROSS AMOUNT	DEDUCTIONS
2001 FEES	022701	Regulatory Filings for SD	250.00	
			250.00	

TC01-044

THIS CHECK IS VOID WITHOUT A COLORED BACKGROUND AND HAS MICROPRINTING

T-NETIX, INC.
67 INVERNESS DRIVE EAST
ENGLEWOOD, CO 80112
(303) 790-9111

BANK ONE, N.A.
CIRCLEVILLE, OH OFFICE
1-800-310-1111
56-1544/441

CHECK NO. 71699
00071699

	DATE	AMOUNT
129	04/13/01	$********250

PAY

TWO HUNDRED FIFTY AND 00/100 **

TO THE
ORDER OF:

South Dakota Public Utilities Commission
State Capitol Building
500 East Capitol Avenue
Pierre, SD 57501-5070

⑈071699⑈ ⑆044115443⑆ 627120157⑈

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF T-NETIX TELECOMMUNICATIONS SERVICES, INC. FOR A CERTIFICATE OF AUTHORITY TO PROVIDE INTEREXCHANGE TELECOMMUNICATIONS SERVICES IN SOUTH DAKOTA	)	ORDER GRANTING CERTIFICATE OF AUTHORITY TC01-044

On April 23, 2001, the Public Utilities Commission (Commission), in accordance with SDCL 49-31-3 and ARSD 20:10:24:02 and 20:10:24:05, received an application for a certificate of authority from T-NETIX Telecommunications Services, Inc. (T-NETIX).

T-NETIX proposes to offer specialized call processing and other services to the corrections industry. The services will be limited to collect calls initiated by inmates from coin telephones in correctional facilities. T-NETIX will offer call control features including: one-way, out-going only service; blocked access to "411," 800/888/877, 900 and other calls; caller ID blocking to outside parties, and call recording and management. A proposed tariff was filed by T-NETIX. The Commission has classified long distance service as fully competitive.

On April 26, 2001, the Commission electronically transmitted notice of the filing and the intervention deadline of May 11, 2001, to interested individuals and entities. No petitions to intervene or comments were filed and at its May 8, 2001, meeting, the Commission considered T-NETIX's request for a certificate of authority. Commission Staff recommended granting a certificate of authority, subject to the condition that T-NETIX not offer a prepaid calling card or require deposits or advance payments without prior approval of the Commission. Commission Staff further recommended a waiver of ARSD 20:10:24:02(8) and 20:10:24:05(4), (6) and (7).

The Commission finds that it has jurisdiction over this matter pursuant to SDCL Chapter 49-31, specifically 49-31-3 and ARSD 20:10:24:02 and 20:10:24:03. The Commission finds that T-NETIX has met the legal requirements established for the granting of a certificate of authority. T-NETIX has, in accordance with SDCL 49-31-3, demonstrated sufficient technical, financial and managerial capabilities to offer telecommunications services in South Dakota. Further, the Commission finds that there is good cause to waive ARSD 20:10:24:02(8) and 20:10:24:05(4), (6) and (7). The Commission approves T-NETIX's application for a certificate of authority, subject to the condition that T-NETIX not offer a prepaid calling card or require deposits or advance payments without prior approval of the Commission. As the Commission's final decision in this matter, it is therefore

ORDERED, that T-NETIX's application for a certificate of authority is hereby granted, effective June 22, 2001, subject to the condition that T-NETIX not offer a prepaid calling card or require deposits or advance payments without prior approval of the Commission. It is

FURTHER ORDERED, that the Commission finds good cause to waive ARSD 20:10:24:02(8) and 20:10:24:05(4), (6) and (7).

FURTHER ORDERED, that T-NETIX shall file informational copies of tariff changes with the Commission as the changes occur.

Dated at Pierre, South Dakota, this 14th day of May, 2001.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that this document has been served today upon all parties of record in this docket, as listed on the docket service list, by first class mail, in properly addressed envelopes, with charges prepaid thereon.

By: Delaine Kolbo

Date: 5/15/01

(OFFICIAL SEAL)

BY ORDER OF THE COMMISSION:

James A. Burg

JAMES A. BURG, Chairman

Pam Nelson

PAM NELSON, Commissioner

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

CERTIFICATE OF AUTHORITY

To Conduct Business As A Telecommunications Company
Within The State of South Dakota

Authority was Granted effective as of June 22, 2001
Docket No. TC01-044

This is to certify that

T-NETIX TELECOMMUNICATIONS SERVICES, INC.

is authorized to provide interexchange telecommunications services in South Dakota, subject to the condition that it not offer a prepaid calling card or require deposits or advance payments without prior approval of the Commission.

This certificate is issued in accordance with SDCL 49-31-3 and ARSD 20:10:24:02, and is subject to all of the conditions and limitations contained in the rules and statutes governing its conduct of offering telecommunications services.

Dated at Pierre, South Dakota, this 14th day of May, 2001.

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION:

James A Burg

JAMES A. BURG, Chairman

Pam Nelson

PAM NELSON, Commissioner